

Indiana Law Review



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1989 Survey of Recent Developments

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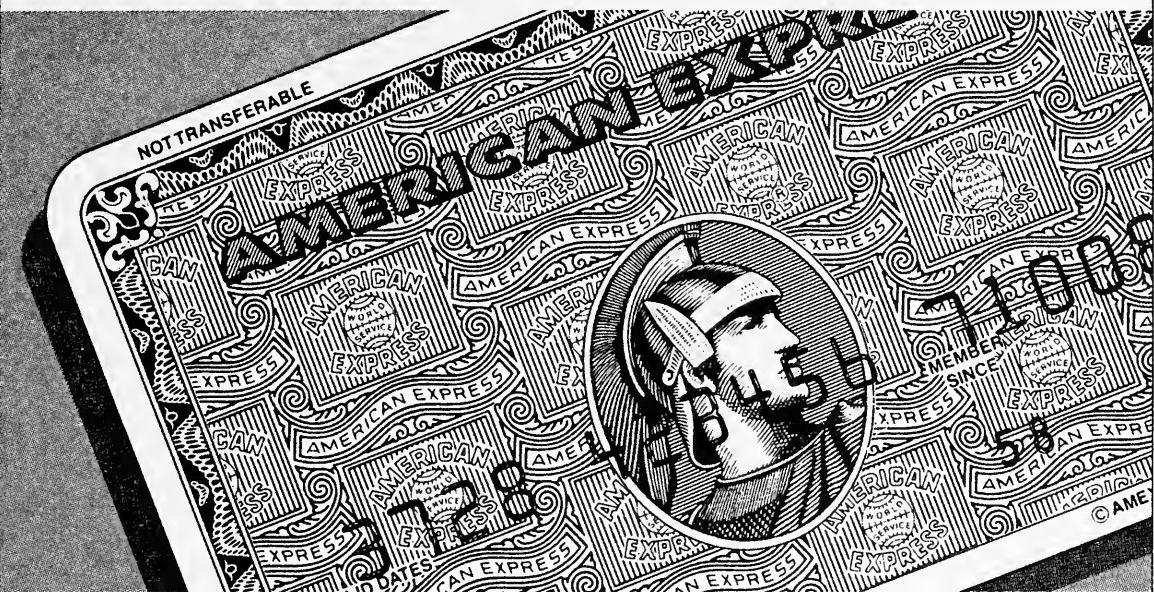
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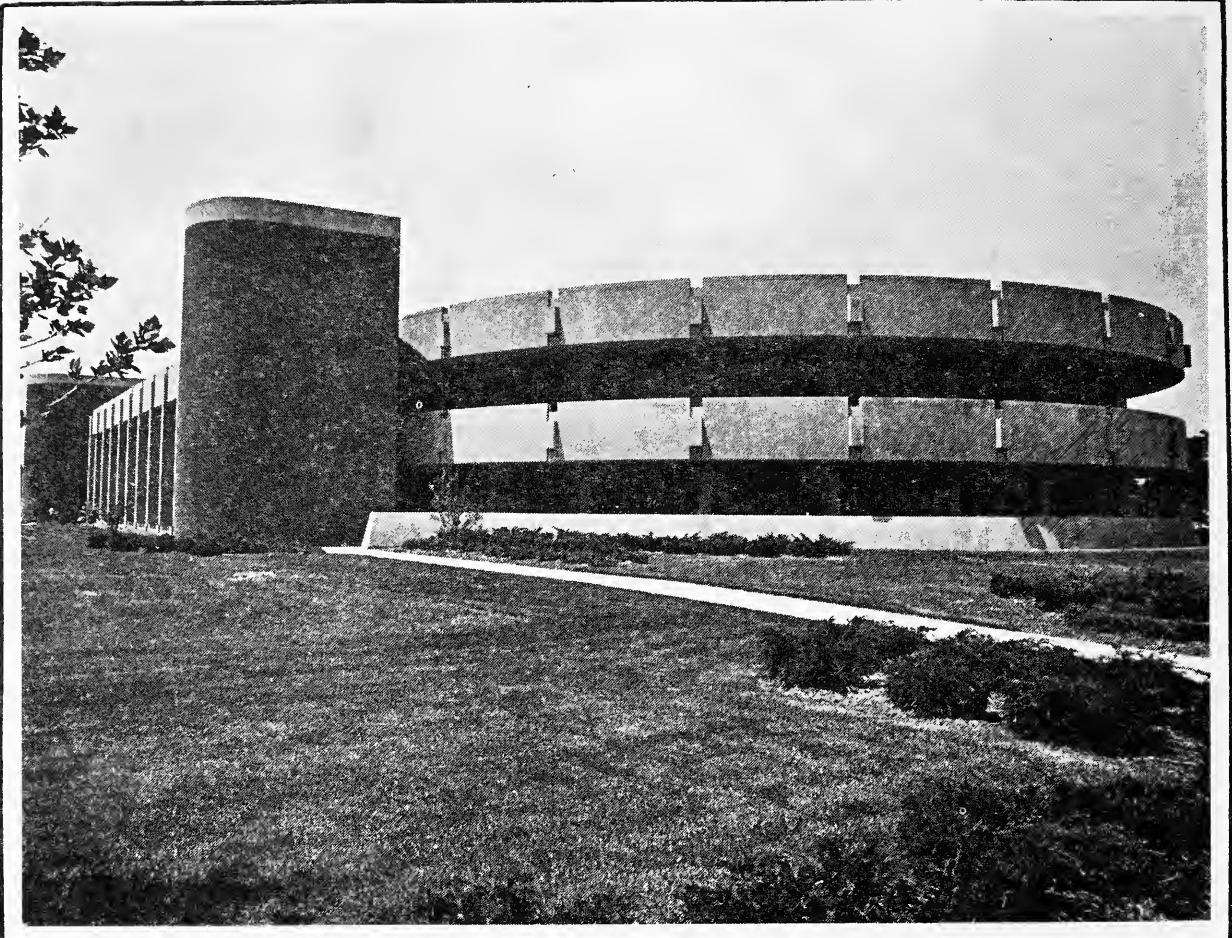
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Oral Warranties and Written Disclaimers in Consumer Transactions: Indiana's End Run Around the U.C.C. Parol Evidence Rule

HAROLD GREENBERG*

In the course of promoting their products, manufacturers and sellers often engage in extensive advertising campaigns aimed at prospective buyers, whether ordinary consumers or commercial buyers. Later, when the seller and buyer are face to face either in the seller's store or showroom, or when a seller's representative calls on the buyer, sales personnel frequently extol the qualities of the goods and answer the buyer's questions before the parties sign a contract of sale. Both the advertising and the statements of the seller may constitute express warranties of the goods.¹ However, the written contract of sale often contains a provision that disclaims all warranties other than those set forth in the writing, and the writing frequently does not set forth any of the warranties contained in the advertising or made by the seller's representative. The contract may also contain a merger clause which states that the writing sets forth the entire agreement between the parties.

The conflict between the oral warranty and the written disclaimer requires an analysis of two provisions of the Uniform Commercial Code: the section authorizing the disclaimer of express warranties and the Code's version of the parol evidence rule. Section 2-316(1) of the Code states:

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1. See U.C.C. § 2-313(1) (1972) and IND. CODE § 26-1-2-313(1) (1988). The seller makes an express warranty when he makes a statement of fact or promise which relates to the goods, describes the goods, or shows a sample or model, and the statement, promise, description, sample, or model becomes "part of the basis of the bargain" between the parties. *Id.*

In this article all citations to the Code will be to the generic section numbers, e.g., § 2-313(1), rather than to the Indiana Code citation, unless the Indiana Code differs from the Official 1972 Draft.

Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed whenever reasonable as consistent with each other; but *subject to the provisions of [§ 2-202]* on parol or extrinsic evidence, negation or limitation is inoperative to the extent that such construction is unreasonable.²

The Code's parol evidence rule, section 2-202, states:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

- (a) by course of dealing or usage of trade [§ 1-205] or by course of performance [§ 1-208]; and
- (b) by evidence of consistent additional terms, unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.³

Section 2-316 creates two problems: how to construe an express warranty and a disclaimer of express warranty so they are consistent with each other, and how to apply the parol evidence rule in the event the alleged express warranty is oral and the written contract contains either a disclaimer clause with which the warranty is inconsistent or a merger clause which purports to exclude all parol evidence, including that of an oral warranty.⁴

The Code conflict between oral warranties and written disclaimers has sparked much comment.⁵ Indiana's resolution of the conflict, particularly in consumer cases, is troublesome given these provisions of the Code, some recent cases, and Indiana's historical approach to the parol

2. U.C.C. § 2-316(1) (1972) (emphasis added).

3. *Id.* § 2-202.

4. *See id.* § 2-316.

5. *See, e.g., Jordan v. Doonan Truck & Equip., Inc.*, 220 Kan. 431, 435, 552 P.2d 881, 883 (1976); Duesenberg & King, *Sales and Bulk Transfers under the Uniform Commercial Code*, 3 U.C.C. Serv. (MB) § 6.06 (1988) [hereinafter Duesenberg & King]; J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 12-4 (3d ed. 1988) [hereinafter WHITE & SUMMERS]; Broude, *The Consumer and the Parol Evidence Rule: Section 2-202 of the Uniform Commercial Code*, 1970 DUKE L.J. 881, 914-18 (1970); Ezer, *The Impact of the Uniform Commercial Code on the California Law of Sales Warranties*, 8 UCLA L. REV. 281, 310 (1961); Note, *Implied and Express Warranties and Disclaimers under the Uniform Commercial Code*, 38 IND. L.J. 648 (1963).

evidence rule. The most recent cases involving this problem, *Carpetland U.S.A. v. Payne*,⁶ and *Travel Craft, Inc. v. Wilhelm Mende GmbH & Co.*,⁷ are the focus of this Article.

I. THE CASES

Before she purchased new carpet for her son's home, Bezzel Payne was assured by the salesman that the carpet was guaranteed for one year and that the seller would replace it if any defects appeared within that time.⁸ However, the printed sales contract presented for her signature stated on the reverse side, in light gray, capital letters under the heading "OTHER TERMS AND CONDITIONS":

EXCEPT FOR DESCRIPTION ON REVERSE SIDE HEREOF, BUYER ACKNOWLEDGES THAT NO EXPRESS OR IMPLIED WARRANTIES (INCLUDING WARRANTIES OF MERCHANTABILITY OR FITNESS) HAVE BEEN MADE BY SELLER AND SELLER HEREBY DISCLAIMS ALL SUCH WARRANTIES. THERE ARE NO WARRANTIES WHICH EXTEND BEYOND THE FACE HEREOF."⁹

The only descriptions on the face of the contract were "100% nylon pile" and "Mustang Mahogany."¹⁰ Within a few weeks after installation, the pile began to come loose and bald spots appeared. A representative of the seller examined the carpet, trimmed the loose fibers, and gave instructions to trim any additional loose fibers. When the seller refused to replace the carpet, Mrs. Payne sued for breach of warranty. She was permitted by the trial court to introduce evidence of the salesman's oral representations, and ultimately recovered for breach of express warranty. The seller appealed.

The Indiana Court of Appeals, quoting section 2-316(1),¹¹ concluded that the oral warranty and the written disclaimer of express warranties were inconsistent, and ruled that the disclaimer was inoperative. In so doing, the court noted its awareness "that this holding seemingly ignores the parol evidence provision"¹² of the Code, and compared the approaches to the problem as expressed by White & Summers¹³ and Duesenberg &

6. 536 N.E.2d 306 (Ind. Ct. App. 1989).

7. 534 N.E.2d 238 (Ind. Ct. App. 1989).

8. *Carpetland*, 536 N.E.2d at 307.

9. *Id.* at 309; Defendant's Trial Exhibit A.

10. Defendant's Trial Exhibit A.

11. See *supra* note 2 and accompanying text.

12. 536 N.E.2d at 309 n.1 (emphasis added).

13. WHITE & SUMMERS, *supra* note 5, at 493-96. (The page citations in the court's opinion are incorrect.)

King.¹⁴ The former would require a parol evidence analysis and would admit evidence of an oral warranty only if the writing was not intended to be the final agreement of the parties.¹⁵ The latter, in the court's words,

[S]uggest that the very existence of a prior oral express warranty indicates that the writing itself was not intended to be a final expression of the parties . . . [and that] whenever a prior oral express warranty is contradicted by a written disclaimer, the parol evidence rule as codified 26-1-2-202 would have no effect on the analysis, and evidence of the oral warranty should be admitted.¹⁶

The court concluded that Indiana has adopted the view of Duesenberg & King so that it is "unnecessary to evaluate the written agreement to determine whether or not it was a final expression of the parties' intent [under the parol evidence rule] before abandoning the parol evidence rule and hearing evidence of prior oral express warranties."¹⁷ Thus, the court completely ignored the statutory mandate that negation or limitation of an express warranty is "subject to the provisions of [§ 2-202] on parol evidence."¹⁸ As noted below, the court's characterization of the Duesenberg & King analysis is not quite accurate.¹⁹

In support of its statement of the Indiana position, the court relied on three decisions: *Woodruff v. Clark County Farm Bureau Coop. Assoc.*,²⁰ *Jones v. Abriani*,²¹ and *Art Hill, Inc. v. Heckler*.²² Although each case involved a prior express warranty followed by a written disclaimer of warranties in the sales contract, and in each case the disclaimer was ruled inoperative, none of the cases mentioned the possible applicability or effect of the parol evidence rule. In *Woodruff*, on which the other two cases relied,²³ the court quoted section 2-316(1), but emphasized only the negation or limitation language, and declared that if there is both an express warranty and a disclaimer of that warranty, the disclaimer is unreasonable and inoperative.²⁴ The *Woodruff* court, as well as the

14. Duesenberg & King, *supra* note 5, § 6.06.

15. See WHITE & SUMMERS, *supra* note 5.

16. *Carpetland*, 536 N.E.2d at 309 n.1 (citations omitted).

17. *Id.*

18. U.C.C. § 2-316(1) (1972).

19. See *infra* notes 46-47 and accompanying text.

20. 153 Ind. App. 31, 286 N.E.2d 188 (1972).

21. 169 Ind. App. 556, 350 N.E.2d 635 (1976).

22. 457 N.E.2d 242 (Ind. Ct. App. 1984).

23. See *Art Hill, Inc.*, 457 N.E.2d at 244; *Jones*, 169 Ind. App. at 571, 350 N.E.2d at 645.

24. *Woodruff*, 153 Ind. App. at 51-52, 286 N.E.2d at 199-200.

courts in *Jones*, *Art Hill*, and *Carpetland*, acted as if the Code language invoking the parol evidence rule did not exist.²⁵

Contrasted with *Carpetland* is *Travel Craft, Inc. v. Wilhelm Mende GmbH & Co.*,²⁶ in which the trial court refused to admit evidence of oral express warranties. After the president of seller Wilhelm Mende GmbH, a producer of aluminum products, solicited business from a number of mobile home manufacturers, including buyer Travel Craft, the parties entered into a sales agreement, the only written component of which was a letter drafted, signed, and sent by the buyer and then signed by the seller. It stated: "The seller agrees for a period of three years from the date of delivery that the product manufactured by it will be free under normal use from substantial defects in materials or workmanship. There are no other warranties, express or implied."²⁷

The Indiana Court of Appeals agreed with the trial court's conclusion that the parties intended the letter to be their final agreement with respect to warranties and that the alleged oral warranties made prior to the letter were properly excluded under the parol evidence rule.

The essential difference between the two cases is that *Carpetland* involved a consumer who was given a pre-printed form to sign and had little, if any, bargaining power, and *Travel Craft* involved two commercial entities who specifically negotiated the warranty language. This may support the different results, but only *Travel Craft* directly confronted

25. The *Art Hill* case, in particular, has been criticized for ignoring the language of the Code, not first examining the parol evidence rule, and then concluding that the written contract was not the full and final expression of the parties' agreement. See B. CLARK & C. SMITH, THE LAW OF PRODUCT WARRANTIES § 8.02[3] (Supp. 1987); Special Project, *Article Two Warranties in Commercial Transactions: An Update*, 72 CORNELL L. REV. 1159, 1263 (1987). The Special Project authors noted, however, that had the court considered the issue, it probably would have achieved the same result favoring the buyer because of the exception to the parol evidence rule under which evidence of fraud is admissible. From the recited facts of the case, it appeared that the seller had made repeated assurances to the buyer that the seller had no intention of fulfilling. *Id.* at 1263-64 n.605.

26. 534 N.E.2d 238 (Ind. Ct. App. 1989).

27. *Id.* at 241. See Affidavit of John Koster, President and Owner of Wilhelm Mende GmbH & Co., in Support of Motion for Summary Judgment, Record at 193-94. The principal issue in *Travel Craft* was the interpretation of the term "normal use," as set forth in the warranties letter. The trial court granted defendant-seller's motion for summary judgment based on seller's affidavit that normal use of its product did not include sidewall construction of motor homes. The Indiana Court of Appeals affirmed because the plaintiff-buyer did not respond by affidavit or otherwise. 534 N.E.2d at 240. However, in view of seller's affidavit that its president had visited the plants of several mobile home manufacturers for the purpose of soliciting their business, it appears that seller's own affidavit raised an issue of fact which could not be resolved on summary judgment, namely, what was the normal use of seller's product if not for use in mobile home manufacture. Stated another way, why did seller solicit mobile home manufacturers if its product was not suitable for use in their products?

the applicability of the parol evidence rule. *Carpetland* ignored it. Had the court in *Carpetland* engaged in a parol evidence rule analysis, as it should have, the result, in all likelihood, would have been the same. Had the court in *Travel Craft* utilized the approach taken in *Carpetland*, however, the result probably would have been different.

II. THE CODE'S POLICIES

The underlying source of the difficulty with *Carpetland*'s approach lies in the language of 2-316(1) and in the apparently contradictory policies expressed by the Code drafters. The section itself has been characterized as "puzzling,"²⁸ a "verbose and confusing mass of language,"²⁹ a matter of "obscure draftsmanship,"³⁰ and expressed "in language that would at once both amaze and delight Gilbert and Sullivan" so that it "says nothing; it means nothing."³¹ The official comment explains that the provision which gives preference to an express warranty over an inconsistent disclaimer, and upon which the *Carpetland* court based its decision, is "to protect a buyer from unexpected and unbar-gained language of disclaimer. . . ."³² The comment continues, however, that "the seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence. . . ."³³ The Code does not deal with true allegations of genuine oral warranties which the seller has thereafter attempted to disclaim.³⁴

In addition to this preference in favor of express warranties over disclaimers, the drafters have stated that:

"Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms.³⁵

* * *

[A]ny fact which is to take such affirmations [i.e., express

28. H. PRATTER & R. TOWNSEND, INDIANA UNIFORM COMMERCIAL CODE WITH COMMENTS 44, § 2-316 comment (1963).

29. Note, *Implied and Express Warranties and Disclaimers Under the Uniform Commercial Code*, 38 IND. L.J. 648, 666 (1963).

30. Broude, *The Consumer and the Parol Evidence Rule: Section 2-202 of the Uniform Commercial Code*, 1970 DUKE L.J. 881, 914.

31. Ezer, *The Impact of the Uniform Commercial Code on the California Law of Sales Warranties*, 8 UCLA L. REV. 281, 310 (1961).

32. U.C.C. § 2-316 comment 1 (1972).

33. U.C.C. § 2-316 comment 2 (1972).

34. See Broude, *supra* note 30, at 918. He concludes that the drafters intended evidence of true warranties to be admissible. *Id.*

35. U.C.C. § 2-313 comment 1 (1972).

warranties] once made, out of the agreement requires clear affirmative proof.³⁶

* * *

A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under Section 2-316[;]

and

But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.³⁷

The background leading to the adoption of the present language of section 2-316(1) is helpful in determining whether the drafters intended that prior express warranties could be excluded under the parol evidence rule.³⁸ Between the time it first appeared in drafts of the Uniform Revised Sales Act and the 1956 revision of the Code which ultimately resulted in the present language, the provision on disclaimer of express warranties stated, in its entirety, "If the agreement creates an express warranty, words disclaiming it are inoperative."³⁹ The comment to this section expressed the very same goals of protecting both the buyer and the seller as does the current comment to section 2-316, described above.⁴⁰

36. U.C.C. § 2-313 comment 3 (1972).

37. U.C.C. § 2-313 comment 4 (1972).

38. *But see* Duesenberg & King, *supra* note 5, at 6-14 to 6-15 (stating that the legislative history is not at all helpful).

39. Unif. Revised Sales Act § 41 (Proposed Final Draft No. 1 1944), in II UNIFORM COMMERCIAL CODE DRAFTS 32 (Kelly 1984); U.C.C. § 2-316(1) (1954 Draft). The origin of this section appears to be in Professor Llewellyn's Notes from SALES ACT § 36 (Prelim. Draft No. 8 1943), in THE KARL LLEWELLYN PAPERS, § J, item V.2.a: "No express warranty can be disclaimed or modified." The classification and indexing of the late Prof. Llewellyn's papers appear in R. ELLINWOOD & W. TWINING, THE KARL LLEWELLYN PAPERS: A GUIDE TO THE COLLECTION (1970). The collection itself is in the library of the University of Chicago Law School and is available in other libraries on microfilm.

40. *See supra* notes 32-33 and accompanying text. The comment to § 2-316 (1949 Draft) states:

1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by prohibiting the disclaimer of express warranties

2. The seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence

VII UNIFORM COMMERCIAL CODE DRAFTS 126 (Kelly 1984).

In his report to the New York State Law Revision Commission in 1955, Professor John Honnold observed that "the most plausible construction" of the parol evidence rule of section 2-202 and of the disclaimer provision of section 2-316(1) was that the drafters did not intend to protect oral express warranties from the operation of the parol evidence rule and that the prohibition against disclaimers of express warranties did not apply until after the parol evidence rule analysis was completed.⁴¹ Professor Honnold's principal problem with the section was that if an agreement was read as a whole, there could be no express warranty in the presence of a disclaimer. On the other hand, if the agreement was read to give meaning to each part, the express warranty could override a disclaimer. Accordingly, he suggested a modification of the section, but he did not include in his modification any reference to the parol evidence rule because he thought it unnecessary.⁴²

In response to Professor Honnold's report, Professor Robert Braucher⁴³ agreed that there were problems with 2-316(1) but rejected Professor Honnold's proposal because it "would also require that words of disclaimer be disregarded in determining whether the agreement creates an express warranty," and "doubt would be cast on the use of written words of disclaimer to exclude inconsistent oral warranties under Section 2-202."⁴⁴ He agreed that the original version of 2-316(1) necessarily involved the parol evidence rule. In place of the Honnold proposal,

41. See Honnold, *Analyses of Sections of Article 2, Part A*, 1 N.Y.L. REV. COMM'N REPORT 355, 406 (1955). But see Duesenberg & King, *supra* note 5, at 6-15; Note, *Implied and Express Warranties and Disclaimers Under the Uniform Commercial Code*, 38 IND. L.J. 648, 668-69 (1963). In commenting on the old § 2-316, Duesenberg & King state: "In the 1952 edition, there would be no question that the oral express warranty would prevail. No reference would have to be made to the parol evidence rule, and it would certainly appear that Section 2-316 would override Section 2-202 where a case of conflict arose." Later, however, they also state, after commenting on the history of the revision, "If it was felt that the parol evidence rule would still exclude prior or contemporaneous oral agreements or warranties, the language in the 1952 edition would go along with that if necessary." Duesenberg & King, at 6-16.

The writer of the Note believed that the original language of § 2-316 required the court to admit evidence of any oral warranties despite the parol evidence rule. 38 IND. L.J. at 668-69.

42. See Honnold, *supra* note 41, at 405-06. The language he suggested was: "(1) To the extent possible, an agreement shall be so construed as to give effect to each part, and words or conduct which otherwise would create an express warranty shall not be denied effect by words of disclaimer." *Id.* at 406.

43. Professor Braucher was chairman of the American Law Institute—National Conference of Commissioners on Uniform State Laws Subcommittee on Article 2. The Code was a joint project of the A.L.I. and N.C.C.U.S.L.

44. Braucher, *Comment on Criticisms of Article 2 Uniform Commercial Code* 49 (1955), a typed memorandum for submission to the N.Y.L. Rev. Comm'n., found in THE KARL LLEWELLYN PAPERS, § J, Item XVII.2.a., at 49-50.

Professor Braucher proposed language which is substantially the same as that of the present section, including the cross-reference to section 2-202.⁴⁵

When the revision was presented to the N.Y.L. Rev. Comm'n. for further consideration, Professor Robert Pasley reported:

The reference to parol or extrinsic evidence (§ 2-202) seems misplaced, since Section 2-202 is clearly applicable where the expressions of warranty and of disclaimer are consistent as well as where they cannot reasonably be construed as consistent. (See Comment 2 to the 1952 Draft.) Apart from this point, the proposed redraft appears to adopt in principle the meaning suggested by Professor Honnold.⁴⁶

The problem being addressed by these three scholars was the difficulty with construction of the language relating to warranties and disclaimers in the writing itself, not to oral warranties conflicting with written disclaimers. All three understood that the parol evidence rule was applicable, no matter how the section was re-drafted to resolve the inconsistency.

The substantial majority of courts and writers agree that a parol evidence rule analysis precedes the resolution of any possible inconsistency between the warranty and the disclaimer.⁴⁷ Even Duesenberg and King, on whom the *Carpetland* court relied for avoiding any parol evidence rule considerations, indicate that such an analysis is required and that

45. *Id.* Professor Braucher stated:

This provision has long been troublesome, and this subcommittee believes that the following counterproposal would clarify it. The cross-reference to Section 2-202 is an afterthought of the chairman not yet considered by the subcommittee:

- (1) [If the agreement creates] words or conduct relevant to the creation of an express warranty and words or conduct relevant to disclaimer of warranty [an express warranty,] shall be construed wherever reasonable as consistent with each other; but [words disclaiming it] subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) disclaimer [are] inoperative to the extent that such construction is unreasonable.

Id.

46. Pasley, *Analyses of Sections of Article 2* (Sections Revised in Supplement No. 1), Part D, in 1 N.Y.L. REV. COMM'N. REPORT 723, 743 (1955).

47. See, e.g., Jordan v. Doonan Truck & Equipment, Inc., 220 Kan. 431, 552 P.2d 881 (1976); Miller v. Hubbard-Wray Co., 52 Or. App. 897, 630 P.2d 880, 883-84 (1981); WHITE & SUMMERS, *supra* note 5, at § 12-4; Braude, *The Consumer and the Parol Evidence Rule: Section 2-202 of the Uniform Commercial Code*, 1970 DUKE L.J. 881, 917; Hogan, *The Highways and Some of the Byways in the Sales and Bulk Sales Articles of the Uniform Commercial Code*, 48 CORNELL L. REV. 1, 8 (1962); Moye, *Exclusion and Modification of Warranty Under the U.C.C.—How to Succeed in Business Without Being Liable for Not Really Trying*, 46 DENVER L.J. 579, 593-95 (1969).

the court should find that the writing was not the final expression of the parties' agreement before reaching the inconsistency issue.⁴⁸ They state that in the apparent conflict between the parol evidence rule of section 2-202 and the present language of 2-316(1), "it seems as though Section 2-202 will prevail at least to the extent that is necessary for the court to determine if the writing is the final expression of the parties' agreement."⁴⁹

What, then, should a court do when this problem arises? The paradox inherent in this problem is that for the court to determine whether or not there was an express warranty with which the disclaimer may be inconsistent under section 2-316, it must consider the buyer's parol evidence of the seller's representations, the very evidence which the seller intended to exclude by the disclaimer and which may be excludable under the parol evidence rule.⁵⁰ But if the representations do not create an express warranty, there is nothing with which the disclaimer is inconsistent under section 2-316 and that section, including the reference to the parol evidence rule, is irrelevant. And if the disclaimer is effective, evidence of warranties inconsistent with it is inadmissible under the parol evidence rule.

The same type of paradox is presented when a party alleges that a written contract was procured by fraud, which invokes a traditional exception to the parol evidence rule. More than one hundred years ago, the Indiana Supreme Court stated that if a warranty does not appear in a written contract, it cannot be proved by parol evidence unless it is alleged to have been false or fraudulent, in which event it is admissible

48. See Duesenberg & King, *supra* note 5, at 6-14. A more complete quotation of their position than that appearing in *Carpetland* is:

The section on parol evidence would seem to say that if the writing is intended to be the final expression of the intent or contract of the parties, then no evidence of prior or contemporaneous terms may be admissible. Of course, it would always be left open for a court to find that the writing itself was not intended as the final expression of the parties. This finding could be based solely on the fact of the existence of the prior oral express warranty. This would seem like circular reasoning by finding that the express oral warranty made the written contract not conclusive, final or complete and, therefore, permitting the express oral warranty to be admissible in evidence. Yet this is the result that seems to be intended by the Code, or at least, if not intended, one that is left open to a court to achieve.

Id.

49. *Id.* at 6-15.

50. See G. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE § 11.11[1][a] (1981), in which the author observes that the buyer must overcome the barrier of the parol evidence rule before the seller is faced with the problem of establishing that the disclaimer is valid.

as evidence of the representation.⁵¹ In such cases, the court will hear the evidence of the alleged fraud in order to determine if there was fraud so as to invoke the exception and permit one party to avoid the contract or recover damages.⁵² If there was no fraud, the exception does not apply and the evidence is not admitted. The courts have been able to deal with the problem without much difficulty.

The resolution of the section 2-316(1) issue of admissibility of an oral warranty and any inconsistency between the warranty and disclaimer therefore depends on the state's policy with respect to how the parol evidence rule should be applied.

III. INDIANA AND THE PAROL EVIDENCE RULE

The Indiana policy on the admissibility of parol evidence has been a conservative one. In non-Code cases, the courts have consistently adhered to a "four corners" approach under which there is a conclusive presumption as a matter of substantive law that if a written agreement appears to be complete on its face, it contains the entire agreement of the parties. In the absence of such factors as fraud, mistake, illegality, duress, ambiguity, or undue influence, parol or extrinsic evidence will not be admissible to add to, vary, or explain the writing's terms.⁵³ Moreover, because the parol evidence rule is a rule of substantive law, the courts may not consider such evidence even if it is admitted at trial without objection.⁵⁴ By 1950, it was well settled in Indiana that "[w]here a written contract of warranty is made, oral warranties and implied warranties are all merged in the written contract, and by its terms the parties must be bound, as in other cases of written agreements."⁵⁵ Thus, in another pre-Code case involving the sale of a used automobile, the court stated the rule to be that "in the absence of fraud or mistake an express warranty cannot be shown by parole [sic] evidence where the

51. *McClure v. Jeffrey*, 8 Ind. 79, 83 (1856). See *Vernon Fire & Casualty Ins. Co. v. Thatcher*, 152 Ind. App. 692, 701, 285 N.E.2d 660, 666 (1972).

52. *Vernon Fire & Casualty Ins. Co. v. Thatcher*, 152 Ind. App. 692, 701, 285 N.E.2d 660, 667 (1972).

53. See, e.g., *Lewis v. Burke*, 248 Ind. 297, 305, 226 N.E.2d 332, 337 (1967); *Creech v. LaPorte Prod. Cred. Ass'n*, 419 N.E.2d 1008, 1010 (Ind. Ct. App. 1981); *Hauck v. Second Nat'l Bank*, 153 Ind. App. 245, 260-63, 286 N.E.2d 852, 861 (1972).

54. See *Franklin v. White*, 493 N.E.2d 1161, 1165-66 (Ind. 1986); *Hancock v. Kentucky Central Life Ins. Co.*, 527 N.E.2d 720 (Ind. Ct. App. 1988).

55. Memorandum of F. M. Schultz to Dean Gavit dated June 24, 1950, prepared in connection with the Summer Institute on the U.C.C.—The Indiana Law of Sales, conducted by Karl Llewellyn and Soia Mentschikoff, THE KARL LLEWELLYN PAPERS, § J, item XII.1.m (quoting *Sullivan Mach. Co. v. Breeden*, 40 Ind. App. 631, 637, 82 N.E. 107, 109 (1907) (quoting *Shirk v. Mitchell*, 137 Ind. 185, 190, 336 N.E. 850, 851 (1894) (citing a long line of cases))).

written contract is complete in all its parts.”⁵⁶ However, parol evidence of alleged fraudulent misrepresentations of the car’s mechanical condition was admissible as an exception to the rule.⁵⁷

The only crack in the strict four-corners approach in non-Code cases appears in *Weaver v. American Oil Co.*,⁵⁸ in which the court first recited the traditional parol evidence rule that an apparently complete writing is conclusively presumed to be fully integrated, and then characterized the rule as “an archaic rule from the old common law” whose only merit is its simplicity.⁵⁹ But the court did not abrogate the rule or the presumption. The issue in *Weaver* was the enforceability of exculpatory and indemnification clauses which the court concluded were unconscionable and contrary to public policy because of one party’s overwhelmingly stronger bargaining power, the other’s lack of knowledge of the existence or meaning of the clauses, and the substantial hardship imposed by the two clauses.⁶⁰ Although *Weaver* is considered a leading case on unconscionability and exculpatory and indemnification clauses,⁶¹ it has also been cited as authority for the conservatively applied parol evidence rule and the presumption of integration,⁶² this despite its criticism of the rule. No other case since *Weaver* has criticized the parol evidence rule in the same manner.⁶³

The touchstone of section 2-202 is the actual intent of the parties. The official comment states that the section rejects “any assumption that because a writing has been worked out which is final on some

56. *Clarke Auto Co. v. Reynolds*, 119 Ind. App. 586, 591, 88 N.E.2d 775, 778 (1949).

57. *Id.*

58. 257 Ind. 458, 276 N.E.2d 144, *reh'g denied* (1971).

59. *Id.* at 464, 276 N.E.2d at 147.

60. In *Weaver*, the service station lease between the lessee, Weaver, and the lessor, American Oil Co., contained clauses which exculpated American from the negligence of its employees and required Weaver to indemnify American against any liability arising from such negligence. An employee of American negligently sprayed Weaver and his employee with gasoline, thereby injuring them. At issue was American’s liability to either Weaver or his employee and Weaver’s duty to indemnify American should Weaver’s employee recover from it.

61. See, e.g., *Franklin v. White*, 493 N.E.2d 161, 165 (Ind. 1986).

62. See *Vernon Fire & Casualty Co. v. Thatcher*, 152 Ind. App. 692, 701, 285 N.E.2d 660, 665 (1972). The court quoted *Weaver*’s characterization of the rule as archaic as being “not material here, yet not without significance.” *Id.* n.6. The reason it was not material was because the case involved actionable misrepresentation or fraud, always admissible under any version of or approach to the parol evidence rule.

63. A search of Lexis on October 16, 1989, disclosed 38 cases in which *Weaver* was cited. With the exception of *Vernon Fire & Casualty Ins. Co.*, discussed in the immediately preceding footnote, none made reference to the comment that the presumption of integration was archaic.

matters, it is to be taken as including all the matters agreed upon. . . ."⁶⁴ This is a rejection of the four-corners rule in favor of a determination by the court of the actual intent of the parties from evidence outside the writing.⁶⁵ Analysis of the rule's effect should involve an examination of all the evidence relating to the parties' actual intent,⁶⁶ including the circumstances surrounding the transaction, such as the relative bargaining strengths of the parties and the ability of one party to control the transaction with a pre-printed contract. Unfortunately, it is possible for a court to look to the language of the Code as requiring a determination of the intent of the parties and still apply a conservative approach in determining that intent.⁶⁷ Thus, a court could conclude that if the buyer has read and signed a contract containing a disclaimer of warranties or a merger clause, evidence of an oral warranty is inadmissible and there is no conflict to be resolved under section 2-316.⁶⁸

Seven Indiana cases have mentioned or discussed section 2-202.⁶⁹ Two, namely, *Carpetland* and *Travel Craft*, are the focus of this Article. In none of the remaining five did the court discuss specifically how to determine if a writing constitutes a total integration. Either there clearly

64. U.C.C. § 2-202 comment 1(a) (1972).

65. See, e.g., R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 69 (1970); Braude, *The Consumer and the Parol Evidence Rule: Section 2-202 of the Uniform Commercial Code*, 1970 DUKE L.J. 881, 916-17; Hadjiyannakis, *The Parol Evidence Rule and Implied Terms: The Sounds of Silence*, 54 FORDHAM L. REV. 35, 49-50 (1985); Note, *Warranties, Disclaimers and the Parol Evidence Rule*, 53 COLUM. L. REV. 858, 861-63 (1953).

66. H. PRATTER & R. TOWNSEND, *supra* note 28, at 23.

67. See Weintraub, *Disclaimer of Warranties and Limitation of Damages for Breach of Warranty Under the UCC*, 53 TEX. L. REV. 60, 74 (1975), in which the author notes that the text of § 2-202 takes no stand on whether a four-corners test is appropriate to determine intention, and that the courts are divided on the issue. He adds that official comment 3 assumes that the court will hear evidence of intent. He concludes, therefore, that because of § 2-202 and comment 3, Texas, which was a four-corners state, would be more likely to admit evidence of oral warranty which would have been excluded under prior law. *Id.* at 74-75.

68. See, e.g., *Green Chevrolet Co. v. Kemp*, 241 Ark. 62, 406 S.W.2d 142 (1966); 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-316:06 (1984).

69. As of October 15, 1989, a Lexis search indicated that the term "26-1-2-202" was cited in eight cases: *Carpetland U.S.A. v. Payne*, 536 N.E.2d 306 (Ind. Ct. App. 1989); *Travel Craft, Inc. v. Wilhelm Mende GmbH & Co.*, 534 N.E.2d 238 (Ind. Ct. App. 1989); *Bowyer v. Vollmar*, 505 N.E.2d 162 (Ind. Ct. App.), *reh'g denied, transf. denied* (1987); *Perfection Cut, Inc. v. Olsen*, 470 N.E.2d 94 (Ind. Ct. App. 1984); *Art Hill, Inc. v. Heckler*, 457 N.E.2d 242 (Ind. Ct. App.), *reh'g denied, transf. denied* (1983); *Front v. Lane*, 443 N.E.2d 95 (Ind. Ct. App. 1982); *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 384 N.E.2d 1084, *reh'g denied, transf. denied* (1979); *Warrick Beverage Corp. v. Miller Brewing Co.*, 170 Ind. App. 114, 352 N.E.2d 496 (1976). The citation to § 2-202 in *Art Hill* was nothing more than the cross-reference to § 2-202 found in the quotation of § 2-316(1).

was no integration which would exclude parol evidence,⁷⁰ or the extrinsic evidence sought to be introduced consisted of usage of trade, course of dealing, or course of performance which are expressly admissible under section 2-202 even if the writing is integrated.⁷¹

How far the Indiana courts will move from the traditional, four-corners rule in determining partial or complete integration remains to be seen. The position of the court in *Carpetland* indicates a most liberal approach to the issue of integration in a case involving the rights of a consumer. This, coupled with the general rule that disclaimers will be construed most strictly against the seller,⁷² indicates that protection of the buyer is a paramount consideration of the court. However, the courts' continued conservative approach to the resolution of alleged ambiguities in written contracts pulls in the opposite direction. With respect to the admissibility of parol evidence to clarify a latent ambiguity, the courts continue to adhere strictly to a four-corners approach.⁷³ Unless the term in question is susceptible to more than one interpretation in the mind of the court, the court will not admit parol evidence as to the meaning of the term.⁷⁴ The fact that the parties disagree as to a term's meaning is not enough to show that there is in fact an ambiguity,⁷⁵ nor will the court admit any extrinsic evidence for purposes of clarification

70. In *Bowyer*, 505 N.E.2d at 164, the writing was a mere sales receipt. *Perfection Cut*, 470 N.E.2d at 94, involved an oral warranty and an oral disclaimer. There was no evidence of a written agreement in *Front*, 443 N.E.2d at 97, and the writing in *Warrick* was held unenforceable because of lack of mutuality.

71. See *Warrick Beverage*, 170 Ind. App. at 121, 352 N.E.2d at 501 (usage of trade, course of dealing, and course of performance are always admissible); *Richards*, 179 Ind. App. at 104-07, 384 N.E.2d at 1087-90 (course of dealing over several months). *Richards* also involved § 2-316, but the primary focus was on the inconsistency of the written disclaimer with written express warranties and the disclaimer's failure to properly disclaim the implied warranty of merchantability. Some mention was made of the disclaimer of oral warranties, 179 Ind. App. at 123, 384 N.E.2d at 1095, but this issue was not developed by the court.

72. See *Richards v. Goerg Boat & Motors, Inc.*, 179 Ind. App. 102, 384 N.E.2d 1084 (1979); *Woodruff v. Clark County Farm Bureau Coop.*, 153 Ind. App. 31, 286 N.E.2d 188 (1972).

73. See, e.g., *Skrypek v. St. Joseph Valley Bank*, 469 N.E.2d 774 (Ind. Ct. App. 1984); *Hauck v. Second Nat'l Bank*, 153 Ind. App. 245, 286 N.E.2d 852 (1972). The four-corners rule for interpretation of written contracts has been strongly condemned by courts and writers. See J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 3-10 (3d ed. 1987).

74. See, e.g., *Turnpaugh v. Wolf*, 482 N.E.2d 506 (Ind. Ct. App.), *reh'g denied* (1985); *Indiana-Kentucky Elec. Corp. v. Green*, 476 N.E.2d 141 (Ind. Ct. App. 1985).

75. See *Hauck v. Second Nat'l Bank*, 153 Ind. App. 245, 286 N.E.2d 852, 863 (1972). But see Note, *Warranties, Disclaimers and the Parol Evidence Rule*, 53 COLUM. L. REV. 857, 861 (1953), where the writer suggests that the mere fact of litigation indicates that the contract means more than expressed within its four corners.

of the parties' intent. That intent may be determined only from the document itself. In effect, the court's understanding of the document is substituted for the parties' actual understanding or intent.

Indiana courts dealing with the issue of integration under the Code should avoid an overly restrictive approach and determine the intent of the parties from their testimony and from the surrounding circumstances before concluding that a contract is or is not partially or fully integrated. Part of that testimony will include evidence of the representations made by the seller. The court must also determine, at least *prima facie*, whether those representations constitute an express warranty. If they do not, there is no inconsistent disclaimer problem under section 2-316 to be resolved. If they do, the court must then apply both sections 2-202 and 2-316 and determine if both parties intended the disclaimer to be the final and exclusive statement of their agreement. For a court to conclude that the existence of an oral warranty automatically precludes the writing from being the final and complete agreement of the parties, as it did in *Carpetland*, is to engage in reasoning which is circular, at best.⁷⁶ Moreover, it completely eliminates the parol evidence rule from every case involving an oral warranty, something which the drafters did not intend.⁷⁷ The making of a prior express warranty is but one factor which goes into the determination; it cannot compel the result. Similarly, a disclaimer clause or a merger clause should be treated like any other written term subject to the parol evidence rule.⁷⁸

IV. SUGGESTED APPROACHES

The Indiana courts have available to them at least three approaches which will enable them to protect the consumer, as was obviously intended in *Carpetland*, without doing violence to the language or intent of section 2-316. The first is based on a presumption of admissibility, the second and third on the traditional concepts of exceptions to the parol evidence rule. Under any of these approaches, the parties are still able to merge

76. See Duesenberg & King, *supra* note 5. One writer has taken the opposite approach and has stated that if there is a disclaimer in the written contract, it "indicates that the parties have reduced all express warranties to writing and the alleged warranty conflicts with" it. Consequently, "since the alleged express warranty cannot be introduced into evidence" under the parol evidence rule, there is no inconsistency to resolve under § 2-316(1). Note, *Implied and Express Warranties and Disclaimers Under the Uniform Commercial Code*, 38 IND. L.J. 648, 670 (1963). This approach is a rigid application of the four-corners rule, with no analysis of the parties' intent whatsoever.

77. See Lord, *Some Thoughts about Warranty Law: Express and Implied Warranties*, 56 N.D.L. REV. 509, 558 (1980).

78. See Franklin v. White, 493 N.E.2d 161 (Ind. 1986); 2 W. HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* § 2-316:06 (1984).

all prior negotiations and representations into the written contract if they intend to do so, as they are empowered to do by sections 2-202 and 2-316,⁷⁹ and as the trial court found they did in *Travel Craft*.

A. *The Presumption of Non-integration in Consumer Transactions*

In a consumer transaction, such as that in *Carpetland*, the court should examine all the facts and circumstances surrounding the execution of the written contract and, specifically, the facts and circumstances leading to the disclaimer clause itself. In *Weaver v. American Oil Co.*,⁸⁰ where the facts showed the service station lessee to be at a substantial disadvantage with respect to his power to negotiate and to understand the contract terms, and the exculpatory and indemnification clauses were so burdensome to the lessee as to cause severe hardship in the eyes of the court, the court declared the terms unconscionable and stated: "The party seeking to enforce such a contract has the burden of showing that the provisions were explained to the other party and *came to his knowledge* and there was in fact *a real and voluntary meeting of the minds and not merely an objective meeting*."⁸¹

In the context of the parol evidence rule, it is not necessary for the court to declare disclaimer clauses unconscionable.⁸² The Code has itself indicated a decided preference in favor of express warranties by providing in section 2-316(1) that as between an express warranty and an inconsistent disclaimer clause, the warranty prevails and the disclaimer is inoperative. While the drafters did not state, in so many words, that a disclaimer inconsistent with a warranty may be substantively unconscionable, as that term is used in section 2-302, the expression of repugnancy for disclaimers⁸³ comes very close.

In consumer transactions, the courts can follow the *Weaver* lead and establish a rebuttable presumption that the existence of an oral warranty indicates that the writing does not express the full and final agreement of the parties. The burden would then be on the seller to

79. See U.C.C. § 2-313 comment 4 (1972).

80. 257 Ind. 458, 276 N.E.2d 144 (1971).

81. *Id.* at 464, 276 N.E.2d at 148 (emphasis in original).

82. Prof. Hawkland doubts that a disclaimer which complies with the Code rules in § 2-316 for conspicuousness and understandability, thereby precluding surprise, could be declared unconscionable. See Hawkland, *Limitation of Warranty Under the Uniform Commercial Code*, 11 HOWARD L.J. 28, 36-37 (1935). Although he was speaking primarily about disclaimers of implied warranties pursuant to § 2-316(2), the same policies should apply as well to disclaimers of express warranties under § 2-316(1). Because the latter subsection creates a superior position for the warranty vis-a-vis the inconsistent disclaimer, an analysis dealing with unconscionability would be unnecessary.

83. See *supra* notes 35-37 and accompanying text.

establish that the parties did intend the writing to be their full and final agreement by showing, first, that the buyer was fully aware of the disclaimer, and second, that she understood what the disclaimer meant and that none of the representations made to her in any advertising or by any salesperson before the signing of the contract applied to the sale. In a situation such as that in *Carpetland*, where new goods were sold at a standard new goods price, it is unlikely that the seller would be able to prove that before the buyer signed the contract, she understood that the one year warranty expressed by the salesman was not applicable, that there were no warranties beyond the statement of fabric content and color, as expressed on the face of the writing,⁸⁴ and that the risk of any product failure was hers. In effect, the seller would be required to demonstrate that the buyer agreed to a contract under which the seller had a "pseudo-obligation."⁸⁵

In a few consumer transactions, the seller may well be able to sustain its burden by showing that the goods were clearly marked "imperfect" or with some other term suggesting flawed goods, that the price was so low that any reasonable buyer would understand that the sale did not involve perfect goods, or that events occurring prior to execution of the contract indicated that there was no express warranty.⁸⁶ In any transaction, whether consumer or commercial, if the evidence shows that the buyer read the written contract, understood its ramifications with respect to warranties, was not surprised by the disclaimer, and agreed to it, the seller should receive the full protection intended by section 2-316.⁸⁷ All of this would be a question of fact.

The presumption would not apply to a purely commercial transaction in which the parties are on a more equal footing and the evidence shows that there were or could have been actual negotiations before the

84. See *supra* note 9.

85. See U.C.C. § 2-313 comment 4, quoted in the text accompanying note 37.

86. See, e.g., Herbert, *What's In a Name?: The Implied Content of Express Warranties*, 12 U. DAYTON L. REV. 297, 300 n.19 (1986). The author gives the example of a used car said to "run great" but which fails to start when the buyer attempts to start it. He suggests that, under these circumstances, the statement never becomes "part of the basis of the bargain" and, therefore, does not give rise to an express warranty at all. *Id.*

87. See, e.g., *Jordan v. Doonan Truck & Equipment, Inc.*, 220 Kan. 431, 552 P.2d 881 (1976) (although there was an oral express warranty, buyer of a truck read the contract, saw the handwritten disclaimer, understood it, and signed; warranty evidence held inadmissible); Lord, *Some Thoughts about Warranty Law: Express and Implied Warranties*, 56 N.D.L. REV. 509, 555-57 (1980); Note, *Uniform Commercial Code: Disclaiming the Express Warranty in Computer Contracts—Taking the Byte Out of the UCC*, 40 OKLA. L. REV. 471, 497 (1987).

writing was signed.⁸⁸ As one writer noted, it makes good sense to give effect to negotiated disclaimers or merger clauses in commercial transactions; it makes no sense to do so in consumer transactions where the buyer seldom reads and even less seldom understands the implications of such provisions.⁸⁹

B. A New Exception to the Parol Evidence Rule: Unequal Bargaining Power

As a consequence of the analysis of *Weaver*, there has been a suggestion that *Weaver* created a new exception to the parol evidence rule: that where there is great disparity in the relative bargaining positions of the parties, prior representations are admissible.⁹⁰ The effect of this new exception would be automatic admissibility of the pre-writing representations, a result much closer to the *Carpetland* approach but still consistent with a preliminary consideration of the parol evidence rule. It could apply in both consumer and commercial transactions where the disparity in bargaining power is apparent as in *Weaver*, which involved a major oil company and a service station operator.

The difference between the presumption, discussed earlier, and the exception to the parol evidence rule is that under the presumption, the seller may still be able to exclude the evidence of warranty if it can show that the parties' ultimate intention was that the warranty not apply and that such intention was reflected in the written disclaimer. Under the exception, if the buyer can satisfy the court that she was in a substantially inferior bargaining position in a consumer or commercial transaction, the evidence comes in. The only questions would be whether the evidence demonstrates the existence of an express warranty and whether the warranty and the disclaimer are inconsistent. If the answers to both questions are affirmative, the warranty prevails. In *Carpetland*, the answer to both questions would have been affirmative.

C. A Traditional Exception to the Parol Evidence Rule: Misrepresentation

Another approach is for the plaintiff to allege and for the court to determine if the making of the oral warranty was a material misrep-

88. See, e.g., *Jaskey Fin. & Leasing v. Display Data Corp.*, 36 U.C.C. Rep. Serv. (Callaghan) 26 (E.D. Pa. 1983); *Ray Martin Painting, Inc. v. Ameron, Inc.*, 638 F. Supp. 768 (D. Kan. 1986) (in both cases, parties were merchants of equal bargaining power).

89. See Braucher, *An Informal Resolution Model of Consumer Product Warranty Law*, 1985 Wis. L. Rev. 1405, 1415-16.

90. See *Grande v. General Motors Corp.*, 444 F.2d 1022, 1027 (7th Cir. 1971); *Vernon Fire & Casualty Ins. Co. v. Thatcher*, 152 Ind. App. 692, 703, 285 N.E.2d 660, 666 n.7 (1972).

representation, evidence of which is admissible despite the parol evidence rule. In *Franklin v. White*,⁹¹ a non-Code case, the seller stated that the real property being sold was suitable for the installation of a septic system. The subsequent written agreement of sale included a virtually iron-clad integration clause which withdrew or merged into the agreement all prior agreements and negotiations and stated that no representation not contained in the writing had induced either party to sign. The Indiana Supreme Court affirmed the admissibility of the septic tank representation as either a mistake of fact or a misrepresentation. It said:

Absent fraud by the seller, a purchaser may seek rescission [sic] of the contract where he has relied upon misrepresentations as to a material fact by the seller. . . . The parol evidence rule has no application to exclude evidence of mistake. . . . Also the parol evidence rule did not exclude Franklin's oral representation because this evidence was admissible to show Franklin's misrepresentation of material fact, whether intentional or not.⁹²

The court characterized the misrepresentation as "constructive or unintentional fraud" and stated: "'The fact that the officer or agent of appellant who made the representations did not know of their falsity, does not bar appellant's recovery.'"⁹³

In order for a representation to constitute an express warranty, it must be "part of the basis of the bargain."⁹⁴ Although the meaning of this statutory language has, in the past, created problems for courts and scholars alike,⁹⁵ the Indiana Court of Appeals has resolved the issue by interpreting the phrase to mean that a buyer is not required to prove actual reliance on the seller's representation but "need only show that the warranty was entered into the contract as an intended element thereof, and as a part of the consideration for the purchase price."⁹⁶

In the context of express warranty, disclaimer, and misrepresentation, the seller should be required to show that once the representation was made, it played no part whatever in the decision of the buyer to purchase the goods. One way of doing this would be to show that the buyer

91. 493 N.E.2d 161 (Ind. 1986).

92. *Id.* at 164.

93. *Id.* at 165 (quoting *Clarke Auto Co. v. Reynolds*, 119 Ind. App. 586, 592, 88 N.E.2d 775, 778 (1949)).

94. U.C.C. § 2-313(1) (1972).

95. See, e.g., H. GREENBERG, RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2, § 14.9 (1987); WHITE & SUMMERS, *supra* note 5, at § 9-5; Coffey, *Creating Express Warranties under the UCC: Basis of the Bargain—Don't Rely on It*, 20 U.C.C. L.J. 115 (1987); Murray, "*Basis of the Bargain*": *Transcending Classical Concepts*, 66 MINN. L. REV. 283, 304 (1982). Prof. Murray characterizes the situation as one of "mass confusion."

96. *Carpetland*, 536 N.E.2d at 308.

knew and understood that the representation was in fact no longer part of the bargain at the time the contract was signed. In a case such as *Carpetland*, the seller would be required demonstrate that Mrs. Payne would still have purchased the carpet although she was told and understood that there was no warranty of quality despite the earlier statement that the carpet was guaranteed for a year.

It should also be noted that pursuant to section 2-721 of the Code as enacted in Indiana, all Code remedies, including recovery of damages, are available for material misrepresentation or fraud, and a successful plaintiff is entitled to recover reasonable attorney's fees.⁹⁷

Furthermore, although not an issue in *Carpetland* because it apparently was not raised by the buyer, a representation by a seller that the goods are covered by a warranty if that representation is false and the seller knows or should know that it is false, is a violation of the Deceptive Consumer Sales Act,⁹⁸ for which a plaintiff may recover damages and attorney's fees.⁹⁹ A seller whose representative states that there is a one year warranty on carpet but whose form contract disclaims all warranties except the description of the goods on its face, has, in all likelihood, violated the Act.¹⁰⁰

Finally, the facts of *Carpetland* indicated that despite the seller's claim of no warranty of quality, a seller's representative did inspect the carpet and trim it on several occasions.¹⁰¹ A similar situation arose in *O'Neil v. International Harvester Co.*,¹⁰² in which the court found that the seller's conduct after the sale tending to show that oral warranties had been made, when taken together with the written contract containing a disclaimer of warranties and an integration clause, created an ambiguity as to whether the parties had intended the writing to be their final expression of intent so as to preclude summary judgment for the seller. The parol evidence was admissible. Applying the Colorado court's reasoning to *Carpetland*, the fact that the seller sent a representative to inspect and repair the defective carpet indicates that the disclaimer was not intended to control and that there was a warranty which the seller attempted, at least initially, to honor.

97. IND. CODE § 26-1-2-721 (1988).

98. See IND. CODE ANN. § 24-5-0.5-3(a)(8) (West Supp. 1989).

99. See *id.* § 24-5-0.5-4(a) (West Supp. 1989).

100. White & Summers suggest that a merger clause should include a disclaimer of the authority of any sales person to make any warranties other than those in the written contract. See WHITE & SUMMERS, *supra* note 5, at 496. Even so, while the authors suggest that a court will have some difficulty in giving effect to prior oral warranties in a consumer transaction, the issue remains whether both parties intended the merger clause to take effect and to exclude those warranties. *Id.* The parol evidence rule remains central.

101. See *Carpetland*, 536 N.E.2d at 307.

102. 40 Colo. App. 369, 575 P.2d 862 (1978).

V. CONCLUSION

Consumer advocates may commend the *Carpetland* decision for its direct approach to giving the buyer what she bargained for and for preventing the seller from inducing a sale by making promises, whether innocently or otherwise, that it did not intend to keep. While the result is probably correct, the decision should be criticized for its failure to follow specific statutory language. The tools are available for achieving the same result if justice and fairness call for that result. They should have been used. With respect to the position of sellers of consumer goods, the best admonition is to train sales people to make only those warranties contained in the written contract of sale or to make no oral warranties whatever,¹⁰³ and to do nothing following the sale which would cast doubt on the finality of the disclaimer. Anything else may result in liability for breach of an express warranty.

On the other hand, in a transaction between parties with relatively equal bargaining positions and understanding of the bargaining process, as were the parties in *Travel Craft*, the way remains open for them to design their agreement as they choose, with all prior negotiations merged into the final, written contract and, therefore, inadmissible to contradict a disclaimer of oral warranties.

The seller will thus be protected from allegations of warranty when the parties intended that there be none, but the buyer will also be protected from unbargained for and unexpected disclaimers or integration clauses which effectively deprive her of the bargain which she was led to believe she was making.

103. See, e.g., 3 A. SQUILLANTE & J. FONSECA, WILLISTON ON SALES § 20-5 (4th ed. 1974); Special Project, *Article Two Warranties in Commercial Transactions*, 64 CORNELL L. REV. 30, 173 (1978).

Procedural Due Process in Postjudgment Garnishment Proceedings: Indiana Keeps up With the Joneses

DAVID L. SIMMONS*

I. JONES V. MARION COUNTY SMALL CLAIMS COURT

Indiana recently joined an increasing number of jurisdictions which have questioned the constitutional requirements of procedural due process in postjudgment garnishment proceedings. Under prior law, a judgment creditor in Indiana was authorized to institute a freeze or hold on the bank account of a judgment debtor for 60 days in conjunction with proceedings supplemental to execution.¹ In *Jones v. Marion County Small Claims Court*² the United States District Court for the Southern District of Indiana decided that Indiana's bank garnishment statute³ violates the Due Process Clause of the fourteenth amendment and therefore is unconstitutional.⁴

The plaintiffs in *Jones* claimed that creditors had garnished bank deposits which were exempt from execution under federal law and that such execution violated procedural due process. Elbert Jones's sole income was \$265.00 per month of social security and \$109.20 of supplementary security income (SSI), all of which was exempt from attachment.⁵ After a judgment was taken against him in the Marion County Small Claims Court, his judgment creditor instituted proceedings supplemental to execution on February 29, 1988 which resulted in a freeze on Jones's bank account.⁶ A hearing was scheduled for twenty-three days later.⁷ As a result of the restriction on his account, checks written for rent and utility bills were dishonored, leaving Jones sixty cents to live on for the remainder of the month.⁸ Jones received no notice of the proceedings supplemental to execution nor of the freeze of his account from the

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1. IND. CODE § 28-1-20-1.1 (1988).

2. 701 F. Supp. 1414 (S.D. Ind. 1988). The court ordered a consolidation of *Jones v. Marion County Small Claims Court*, Lawrence Township Div., IP-88-312-C, and *Long v. Huppert*, IP-88-346-C.

3. IND. CODE § 28-1-20-1.1 (1988).

4. 701 F. Supp. at 1420.

5. *Id.* at 1417 (citing 42 U.S.C. § 407 (1983)).

6. *Id.* at 1421.

7. *Id.*

8. *Id.*

court, although his bank notified him of the freeze on March 2, 1988.⁹ Jones was not informed of any rights to claim his Social Security and SSI funds as exempt from execution, nor of his right to obtain a prompt hearing.¹⁰ Jones subsequently hired counsel who procured the release of the bank deposits on March 17, 1988.¹¹

A plaintiff in a similar action,¹² Charles Long, was permanently disabled and subsisted solely on Social Security disability benefits and disability pension benefits.¹³ On September 11, 1987, he entered into an agreed judgment in the amount of \$1,841.48 with Associates Financial Services Company of Indiana.¹⁴ On January 27, 1988 the judgment creditor commenced proceeding supplemental to execution, and on February 25, 1988 the court ordered Long's bank to put a hold on his account.¹⁵ The amount of \$415.17 was frozen in Long's account.¹⁶ Long ultimately received notice of the freeze on his account by letter from his bank on March 5, 1988.¹⁷ Long received no notice from the court of the proceedings supplemental or the order freezing his account.¹⁸ Long filed a motion to release the funds on March 11, 1988 and on March 14, 1988 the court dissolved the freeze.¹⁹

The plaintiffs filed a consolidated action seeking relief under federal civil rights law,²⁰ and a declaratory judgment²¹ that Indiana's adverse claim statute²² was unconstitutional. On cross motions for summary judgment, the court reviewed the statute in light of its stated purpose to "protect the financial institution, which, in good faith and prior to notice acts on the strength of the phraseology accompanying the deposit."²³ However, the court was clearly more concerned about the constitutional safeguards necessary to protect the indigent individuals who were the subject of the garnishments. The statute required neither notice to the depositor of the action to freeze his account, nor notice

9. *Id.*

10. *Id.*

11. *Id.*

12. *Long v. Huppert*, IP-88-346-C, *consolidated in Jones v. Marion County Small Claims Court*, 701 F. Supp. 1414 (S.D. Ind. 1988).

13. *Jones*, 701 F. Supp. at 1421.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 1422.

19. *Id.*

20. 42 U.S.C. § 1983 (1982).

21. 28 U.S.C. § 2201 (1982 & Supp. 1987).

22. IND. CODE § 28-1-20-1.1 (1988).

23. 701 F. Supp. at 1417 (quoting Grimes, *Aunt Mennee's Portrait*, 10 IND. L. REV. 675, 690 (1977)).

of the depositor's right to claim certain funds as exempt from garnishment.²⁴ Also absent were any provisions requiring a prompt hearing on the issue of exemptions.²⁵

In a rather concise analysis of procedural due process, the court observed that some form of due process is required once a deprivation of protected property has occurred.²⁶ The court also reasoned that a property owner is entitled to due process for even a temporary deprivation of his property rights, citing a line of cases dealing with prejudgment garnishment procedures.²⁷ The court concluded that Indiana Code section 28-1-20-1.1 was unconstitutional since it did not require notice to a depositor of the restriction on his account or of exemptions available under federal or state law.²⁸ The statute was also violated due process since it did not require a prompt hearing for the purpose of identifying exempt funds.²⁹ The court tacitly recognized that the procedural due process required in postjudgment proceedings does not rise to the level of prejudgment proceedings due to the hardships this would work on judgment creditors.³⁰ The holding in *Jones* was specifically limited to funds maintained on deposit in bank accounts or with trust companies or other financial institutions.³¹ *Ex parte* postjudgment seizures of other nonliquid assets were not affected.³²

II. HISTORICAL ANALYSIS OF PROCEDURAL DUE PROCESS

The opinion in *Jones* represents a logical extension of constitutional safeguards required by the fourteenth amendment in garnishment proceedings. The United States Supreme Court first considered procedural due process rights in garnishment proceedings in *Endicott-Johnson Corp. v. Encyclopedia Press, Inc.*³³ In *Endicott*, Encyclopedia Press recovered a judgment against an employee of Endicott and applied for a wage garnishment pursuant to New York statute.³⁴ The statute authorized the

24. *Id.* at 1420.

25. *Id.*

26. *Id.* (citing *In re Special March 1981 Grand Jury*, 753 F.2d 578, 581 (7th Cir. 1985); *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 433 (1968)).

27. 701 F. Supp. at 1420 (citing *In re Special March 1981 Grand Jury*, 753 F.2d 578, 581 (7th Cir. 1985); *Fuentes v. Shevin*, 407 U.S. 57, 85 (1971); *Sniadach v. Family Fin. Corp.*, 395 U.S. 337 (1968)).

28. 701 F. Supp. at 1420.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. 266 U.S. 285 (1924).

34. *Id.* at 287.

garnishment of wages without notice to the affected employee.³⁵ A garnishee defendant, Endicott, refused to withhold the ordered weekly garnishment and continued to pay the employee his entire weekly wage.³⁶ Encyclopedia Press then brought suit against Endicott and recovered judgment for the amount of the garnished wage.³⁷ On appeal, the Supreme Court concluded that once a defendant has had an opportunity to be heard and has had his day in court on the underlying judgment, due process does not require further notice and another hearing before supplemental proceedings can be instituted to enforce the judgment.³⁸ The Court determined that New York's garnishment statute did not violate the requirements of the due process clause, although it did not consider the ramifications of exempt property on the state's execution proceedings.³⁹

Forty-five years later, the Supreme Court revisited the requirements of procedural due process in prejudgment garnishment procedures in *Sniadach v. Family Finance Corp.*⁴⁰ In *Sniadach*, the Court considered the constitutionality of a Wisconsin statute which authorized wage garnishment before the filing of a summons and complaint against a defendant.⁴¹ Family Finance was owed \$420.00 by Sniadach pursuant to a promissory note and garnished Sniadach's wages in conjunction with the filing of a suit.⁴² Sniadach moved for dismissal of the proceeding as violative of the due process requirements of the fourteenth amendment.⁴³ The Wisconsin statute required only that the plaintiff serve the summons and complaint upon the defendant within ten days after service of the garnishment order on the garnishee.⁴⁴ The garnishment procedure was initiated by the clerk of the court who issued the summons at the request of the creditor's lawyer.⁴⁵ The defendant's wages remain garnished until trial of the main suit, at which time they may be unfrozen if the defendant prevails.⁴⁶ In the interim, the defendant was denied an opportunity to be heard or tender a defense.⁴⁷

35. *Id.* at 286.

36. *Id.* at 287.

37. *Id.*

38. *Id.* at 288.

39. *Id.* at 290.

40. 395 U.S. 337 (1969).

41. *Id.* at 338-39.

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 339.

47. *Id.*

The Court reversed lower court findings of constitutionality, holding that wages constituted a unique property interest which warranted special consideration.⁴⁸ While Wisconsin's garnishment procedure may meet the requirements of due process in extraordinary situations, there were insufficient interests present to justify the special protection afforded to a creditor.⁴⁹ Citing *Mullane v. Central Hanover Bank & Trust Co.*,⁵⁰ the *Sniadach* Court reasoned that the right to be heard "has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest."⁵¹ The prejudgment garnishment procedure described in the Wisconsin statute authorized deprivation of property rights which would result in substantial hardship on wage earners with families to support.⁵² In addition, grave injustices may result from a prejudgment garnishment where the sole opportunity to be heard comes after the taking, thereby ensuring enormous leverage to the creditor.⁵³ The Court concluded that the obvious taking of such a fundamental property right requires notice and a prior hearing to satisfy the principles of procedural due process.⁵⁴

A few years later, the Supreme Court considered the requirements of procedural due process in replevin proceedings in *Fuentes v. Shevin*.⁵⁵ In *Fuentes*, the Court reviewed the constitutionality of replevin laws in Florida and Pennsylvania which authorized the summary seizure of goods or chattels in a person's possession. Under the laws of both states, a party could obtain a prejudgment writ of replevin simply upon an *ex parte* application and the posting of a security bond.⁵⁶ Neither statute required notice to the possessor of the property, or an opportunity to challenge the seizure at a hearing.⁵⁷ *Fuentes* was purchasing over time a stove and stereo from Firestone Tire, and had these items repossessed as a result of a service dispute.⁵⁸ Other appellants had also purchased household goods on contract which were the subject of summary replevin proceedings.⁵⁹ Appellant Washington was the subject of a replevin order which authorized the seizure of her child's toys and clothes by her

48. *Id.*

49. *Id.*

50. 339 U.S. 306, 314 (1950).

51. *Sniadach*, 395 U.S. at 339-40.

52. *Id.* at 340.

53. *Id.* at 340-41.

54. *Id.* at 342.

55. 407 U.S. 67 (1972).

56. *Id.* at 69.

57. *Id.* at 70.

58. *Id.*

59. *Id.* at 71.

divorced husband.⁶⁰ The plaintiffs in both cases instituted litigation challenging the constitutionality of the prejudgment replevin statutes under the Due Process Clause of the fourteenth amendment.⁶¹ Both federal district courts upheld the constitutionality of the statutes.⁶²

After tracing the history and evolution of modern day replevin statutes, the Court revisited the central requirements of procedural due process established in *Baldwin v. Hale*⁶³ and its progeny that “[p]arties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified” at a meaningful time and in a meaningful manner.⁶⁴ The Court rejected the narrow interpretation of *Sniadach v. Family Finance Corp.*⁶⁵ urged by the lower courts that a prior hearing is required only with respect to the deprivation of necessary items such as wages and welfare benefits.⁶⁶ The contract right to possess and use goods is a sufficient property interest to invoke the Due Process Clause of the fourteenth amendment because possession and use of a chattel constituted a “significant property interest” worthy of protection.⁶⁷ Prior notice and an opportunity for hearing can be postponed in “extraordinary situations.” But these situations are unusual and narrowly drawn, such as an important general public interest or an overriding need for prompt action.⁶⁸ The Court rejected arguments that the plaintiffs had contractually waived their rights to basic procedural due process, noting that the language of the contract was not a clear waiver.⁶⁹ Both statutes were unconstitutional since they worked a deprivation of property without due process of law.⁷⁰

In 1974, the Supreme Court found that adequate constitutional safeguards were present in a prejudgment sequestration procedure in *Mitchell v. W.T. Grant Co.*⁷¹ In *Mitchell*, the Court considered the constitutionality of a Louisiana statute which authorized the sequestration of property upon application of a creditor claiming a vendor’s lien in the goods. Respondent, W.T. Grant Company, filed suit to recover the unpaid balance of the purchase price for several household items and

60. *Id.* at 72.

61. *Id.* at 71-72.

62. *Id.* at 72.

63. 1 Wall. 223, 233 (1854).

64. *Fuentes*, 407 U.S. at 80.

65. 395 U.S. 337 (1969).

66. 407 U.S. at 88.

67. *Id.* at 86 (quoting *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971)).

68. 407 U.S. at 90-91.

69. *Id.* at 95.

70. *Id.* at 96.

71. 416 U.S. 600 (1974).

further requested a writ of sequestration pursuant to statute.⁷² The statute authorized a writ of sequestration upon *ex parte* application without notice or hearing.⁷³ However, the writ would only issue upon the creditor's affidavit and a judge's authority after the posting of a sufficient bond.⁷⁴ Petitioner, Mitchell, argued that the sequestration was improper since the items were exempt from execution under state law and since the seizure occurred without prior notice or a hearing in violation of due process requirements.⁷⁵ The trial court held that the provisional seizure was not a denial of due process, and this ruling was upheld on appeal to the Louisiana appellate and supreme courts.⁷⁶

The Supreme Court reasoned that Respondent, W.T. Grant, had a vendor's lien in the goods and therefore due process must take into account the interests of both buyer and seller.⁷⁷ The Court distinguished *Sniadach*⁷⁸ on the grounds that it dealt exclusively with prejudgment garnishment of wages, a property interest in which the creditor had no prior interest.⁷⁹ Nor did the Court find the reasoning of *Fuentes*⁸⁰ dispositive since it involved state statutes which authorized replevin of property without prior notice or a hearing, and without judicial participation.⁸¹ The Louisiana statute in question was not violative of due process given the requirements of an affidavit, the posting of a bond, and an opportunity for a prompt post-seizure hearing.⁸² In addition, the Louisiana law required judicial control of the process from beginning to end.⁸³ Since the Louisiana system minimized the risk of error of a wrongful interim possession by the creditor, it protected the debtor's interest in every conceivable way, thereby fulfilling the requirements of due process under the fourteenth amendment.⁸⁴

The following year, the Supreme Court considered due process requirements in prejudgment garnishment of commercial property in *North Georgia Finishing, Inc. v. Di-Chem, Inc.*⁸⁵ In *North Georgia*, Di-Chem filed its suit against North Georgia alleging an indebtedness due and

72. *Id.* at 601-02.

73. *Id.* at 606.

74. *Id.*

75. *Id.* at 602-03.

76. *Id.* at 603.

77. *Id.* at 604.

78. 395 U.S. 337 (1969).

79. 416 U.S. at 614.

80. 407 U.S. 67 (1972).

81. 416 U.S. at 615, 616.

82. *Id.*

83. *Id.*

84. *Id.* at 618.

85. 419 U.S. 601 (1975).

owing for goods sold and delivered in the amount of \$51,279.17.⁸⁶ Upon filing of the complaint but prior to service of process, Di-Chem filed its affidavit and bond with the Superior Court, requesting garnishment of a North Georgia bank account pursuant to statute.⁸⁷ A few days later, North Georgia filed its bond for the payment of any final judgment, and the judge discharged the bank garnishment.⁸⁸ North Georgia then initiated proceedings to discharge its bond, asserting, among other things, that the statutory garnishment procedure was a violation of its constitutional rights of due process and equal protection.⁸⁹ The motion was overruled by the trial court and an appeal to the Georgia Supreme Court was unsuccessful.⁹⁰

The Supreme Court agreed with the appellants in *North Georgia*, finding that the Georgia garnishment statute had none of the saving characteristics of the Louisiana statute discussed in *Mitchell v. W.T. Grant Co.*⁹¹ The Court also rejected a narrow application of *Fuentes*⁹² or *Mitchell*⁹³ to limit due process in consumer cases, refusing to "distinguish among different kinds of property in applying the Due Process Clause."⁹⁴ Rather, the Georgia statute was defective since the debtor's property interest was impounded without the posting of a bond, without notice or hearing, upon the entry of a court clerk.⁹⁵ The Court concluded that the probability of irreparable injury under the circumstances is sufficiently great that additional procedural safeguards are necessary to ensure constitutional compliance.⁹⁶

Procedural due process was again considered by the Supreme Court in the 1976 opinion of *Mathews v. Eldridge*,⁹⁷ although in the context of administrative proceedings which resulted in the termination of social security benefits. Respondent Eldridge was awarded disability benefits under the Social Security Act in June of 1968.⁹⁸ In 1972, a state agency concluded that his disability had ceased and that Eldridge would no longer be entitled to benefits.⁹⁹ The agency requested additional infor-

86. *Id.* at 604.

87. *Id.*

88. *Id.*

89. *Id.* at 604-05.

90. *Id.* at 605.

91. *Id.* at 606. *See supra* notes 71-84 and accompanying text.

92. *Id.* at 605-06. *See supra* notes 55-62 and accompanying text.

93. *Id.* at 608.

94. *Id.*

95. *Id.* at 607.

96. *Id.* at 608.

97. 424 U.S. 319 (1976).

98. *Id.* at 323.

99. *Id.* at 324.

mation pertaining to his condition but Eldridge responded that the agency already had enough evidence to establish his disability.¹⁰⁰ The agency and the Social Security Administration subsequently notified Eldridge that his benefits had been terminated, after which he commenced an action in the federal district court challenging the constitutional validity of applicable administrative procedures.¹⁰¹ The trial court held that since disability determinations may involve subjective judgments based on conflicting medical and nonmedical evidence, Eldridge had to be afforded an evidentiary hearing of the type required for welfare beneficiaries of the Social Security Act.¹⁰² The Court of Appeals for the Fourth Circuit affirmed the opinion of the trial court.¹⁰³

The United States Supreme Court reversed the lower court decisions, finding that Eldridge had been afforded sufficient procedural due process to satisfy the fourteenth amendment.¹⁰⁴ The Court narrowed its consideration to whether the Due Process Clause requires an evidentiary hearing before termination of Eldridge's benefits. The Court rejected a rigid formulation of constitutional safeguards, and adopted a flexible approach to due process which requires the implementation of whatever safeguards are necessary to assure fairness.¹⁰⁵ A balancing test comprised of three factors was devised to analyze the required due process for any given situation: first, the private interest to be affected by the official action; second, the risk of an erroneous deprivation and the probable value of additional or substitute procedural safeguards; and third, the government's interest in the procedure, including the fiscal and administrative burdens incurred as a result of the additional or substitute procedural requirements.¹⁰⁶ The Court concluded that an evidentiary hearing under the circumstances was not required since Eldridge had the opportunity to meet the objections raised before final administrative action, and the opportunity for an evidentiary hearing and judicial review before the denial of the claim becomes final.¹⁰⁷

The Supreme Court has not addressed the requirements of procedural due process in postjudgment garnishment proceedings since its 1924 opinion of *Endicott-Johnson Corp. v. Encyclopedia Press, Inc.*¹⁰⁸ However, due process standards in postjudgment proceedings have been

100. *Id.*

101. *Id.* at 324-25.

102. *Id.* at 325-26.

103. *Id.* at 326.

104. *Id.* at 349.

105. *Id.* at 348.

106. *Id.* at 335.

107. *Id.* at 349.

108. 266 U.S. 285 (1924).

examined by the Third and Fifth Circuit Courts of Appeal. In *Brown v. Liberty Loan Corp.*,¹⁰⁹ Liberty Loan received a judgment in the amount of \$646.03 against Brown.¹¹⁰ Twelve days later, Liberty Loan issued a writ of garnishment pursuant to Florida statute to Brown's employer.¹¹¹ Brown received no notice of the garnishment proceedings prior to service of the writ of garnishment on her employer.¹¹² On the day the writ was served, Brown filed her affidavit of exemption pursuant to statute, to which Liberty responded by filing an affidavit denying the exemption.¹¹³ After hearing, the court found that Brown was qualified for the state exemption and dissolved the writ of garnishment.¹¹⁴ Brown subsequently brought a class action in federal district court challenging the constitutionality of the Florida statute and requesting declaratory relief and monetary damages.¹¹⁵ The district court found that the Florida statute violated due process since it authorized garnishment of wages without prior notice and an opportunity for hearing, and Liberty appealed.¹¹⁶

The Fifth Circuit Court of Appeals reversed the trial court, delivering an extensive analysis of the competing interests of both the state and individuals involved in debt collection. The interests of the judgment debtor include the disfavored status of garnishment proceedings, the requirements of notice and hearing, the deprivation of wages, and the risk of discharge from employment to avoid administrative burdens.¹¹⁷ Against these interests, however, must be weighed the state's interest in the enforcement of judgments and the creditor's interest in satisfying its judgment.¹¹⁸ The court distinguished the holdings in *Sniadach*¹¹⁹ and its progeny since these cases dealt with the harms attendant to pre-judgment garnishments.¹²⁰ Consequently, there is no requirement that notice and a hearing must precede postjudgment garnishment of wages.¹²¹ The court concluded that procedural due process was not violated by the Florida garnishment procedure since there were several statutory provisions which, on balance, provided a measure of protection for the judgment debtor.¹²² A prompt judicial determination of the debtor's

109. 539 F.2d 1355 (5th Cir. 1976), *cert. denied*, 430 U.S. 949 (1977).

110. *Id.* at 1357.

111. *Id.*

112. *Id.* at 1357-58.

113. *Id.* at 1358.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.* at 1363.

118. *Id.*

119. 395 U.S. 337 (1969).

120. 539 F.2d at 1365-66.

121. *Id.* at 1368.

122. *Id.*

claim of exemption was required and the notice provided in the underlying proceedings at least alert the debtor that further legal action may be taken to satisfy the judgment.¹²³ The court criticized the garnishment statute for allowing a writ of garnishment to issue upon an unsworn motion of the judgment creditor, but noted that the use of procedures approved in *Mitchell*¹²⁴ would "reduce the incidence of wrongful garnishment."¹²⁵

The Third Circuit Court of Appeals reached a different conclusion in *Finberg v. Sullivan*,¹²⁶ which considered the constitutionality of Pennsylvania's postjudgment garnishment procedures. In *Finberg*, the Sterling Consumer Discount Company obtained a default judgment against Finberg, a 68 year old widow, whose sole source of income was social security retirement benefits.¹²⁷ Sterling immediately initiated garnishment procedures which resulted in Finberg's bank account totaling \$550.00 being frozen. The bank account consisted of social security benefits.¹²⁸ She received no notice of the garnishment action and had no opportunity to assert her exemption claims prior to the attachment.¹²⁹ After the attachment, she received no notice that her accounts might be exempt from garnishment or of procedures available for obtaining a release of exempt property.¹³⁰ None of these measures was required under the Pennsylvania law.¹³¹ Finberg obtained the release of \$300.00 from her account nearly six weeks after the writ was issued, with the balance being released on May 30, 1978, over six months after the original garnishment.¹³² During the pendency of the state court garnishment proceeding, Finberg challenged the constitutionality of Pennsylvania's postjudgment garnishment procedures in federal court. The court ultimately held that the statute contained sufficient protection for the judgment debtor to satisfy the Due Process Clause and avoid conflict with the Social Security Act exemption.¹³³

On appeal, the Third Circuit Court of Appeals considered the Pennsylvania statute in the historical context of procedural due process as it has evolved from *Endicott*¹³⁴ through the prejudgment cases of *Snia-*

123. *Id.*

124. 416 U.S. 600 (1973).

125. *Brown*, 539 F.2d at 1369.

126. 634 F.2d 50 (3d Cir. 1980).

127. *Id.* at 51.

128. *Id.* at 52.

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* at 53.

134. 266 U.S. 285 (1924).

dach,¹³⁵ *Fuentes*,¹³⁶ *Mitchell*,¹³⁷ and *North Georgia*.¹³⁸ The Court reasoned that *Endicott*¹³⁹ was not controlling since it did not address the issue of the debtor's exempt property, and instead relied solely on the later prejudgment cases for relevant analysis.¹⁴⁰ These cases do not require notice and an opportunity to be heard prior to postjudgment garnishment so long as the debtor is protected from "erroneous or arbitrary seizures."¹⁴¹ "The procedural protection is adequate if it represents a fair accommodation of the respective interests of creditor and debtor."¹⁴² Noting that a fundamental requirement of due process is an opportunity to be heard at a meaningful time, the court found that Pennsylvania's garnishment statutes violated the Due Process Clause since it failed to require a prompt post-seizure hearing and adjudication of exemption claims.¹⁴³ Considering that the garnished bank account may well contain money needed by a person for food, shelter, health care and other basic requirements of life, the debtor is entitled to an especially prompt hearing.¹⁴⁴ The Court further determined that the notice received by Finberg failed to inform her of the exemption available under federal law, or of the existence of a state exemption or of the procedure for claiming these exemptions.¹⁴⁵ The failure to so notify Finberg with this information was a violation of due process.¹⁴⁶ In a colorful and angry dissent, Justice Aldisert criticized the majority for failing to acknowledge the interest of the creditor as possessor of a valid judgment vis-a-vis *Brown*¹⁴⁷ and the inevitable economic impact resulting from the Court's ruling.¹⁴⁸

More recently, the Seventh Circuit considered the requirements of procedural due process in a 1986 opinion, *Del's Big Saver Foods, Inc. v. Carpenter Cook, Inc.*¹⁴⁹ In *Del's*, the Seventh Circuit considered the constitutionality of Wisconsin's replevin statute which was used to seize a grocery store. *Del's* provided Carpenter Cook with a security interest

135. 395 U.S. 337 (1969).

136. 407 U.S. 67 (1972).

137. 416 U.S. 600 (1974).

138. 419 U.S. 601 (1975).

139. 266 U.S. 285 (1924).

140. *Finberg v. Sullivan*, 634 F.2d at 56-57.

141. *Id.* at 58.

142. *Id.*

143. *Id.* at 61.

144. *Id.* at 59.

145. *Id.* at 61-62.

146. *Id.* at 62.

147. *Id.* at 72.

148. *Finberg*, 634 F.2d at 85-86.

149. 795 F.2d 1344 (7th Cir. 1988).

in both inventory and fixtures to secure the obligations of a promissory note.¹⁵⁰ Upon Del's default, Carpenter Cook obtained an *ex parte* order of replevin which directed Del's to surrender all collateral and directed Carpenter Cook to assume control over the operations of the store.¹⁵¹ The writ of replevin was issued upon Carpenter Cook's affidavit, under the supervision of the court, after the posting of a \$100,000 bond.¹⁵²

The replevin statute authorized an immediate post-deprivation hearing, but one was never requested.¹⁵³ Nearly three months after entry of the replevin order, Del's filed suit in federal court alleging deprivation of its property rights without due process of law.¹⁵⁴ The federal district court granted Carpenter Cook's motion to dismiss, and shortly thereafter, the Wisconsin state court entered judgment against Del's on the allegations of Carpenter Cook's complaint.¹⁵⁵

The Seventh Circuit of Appeals affirmed the lower court's dismissal, noting that sufficient safeguards were present under Wisconsin statute to satisfy constitutional requirements of procedural due process.¹⁵⁶ The costs of delay for a pre-deprivation hearing under the circumstances were too great since the creditor must move rapidly to liquidate the collateral.¹⁵⁷ The court also found fault with Del's since it failed to utilize any of the available state procedures for obtaining an immediate hearing on the replevin.¹⁵⁸ Wisconsin's replevin procedure provided adequate constitutional safeguards such as detailed factual allegations under oath, and judicial supervision.¹⁵⁹ The statute also requires the posting of a bond by the creditor, that the order be issued by a judge, and a prompt hearing is available to the debtor upon request.¹⁶⁰

III. INDIANA'S ADVERSE CLAIM STATUTE FAILED TO PROVIDE JUDGMENT DEBTORS WITH PROCEDURAL DUE PROCESS

Both judgment creditors in *Jones*¹⁶¹ commenced proceedings supplemental to execution against the defendants pursuant to Trial Rule 69(E)¹⁶²

150. *Id.* at 1345.

151. *Id.*

152. *Id.*

153. *Id.* at 1348.

154. *Id.* at 1345-46.

155. *Id.*

156. *Id.* at 1351.

157. *Id.* at 1348.

158. *Id.* at 1347.

159. *Id.* at 1351.

160. *Id.* at 1347.

161. 701 F. Supp. 1414. *See supra* notes 1-35 and accompanying text.

162. IND. R. TR. P. 69.

and several statutory sections.¹⁶³ As was customary practice in Indiana at the time, bank interrogatories were filed with the court in connection with the proceeding supplemental and thereafter forwarded to banks which were holding deposits for the defendants.¹⁶⁴ Indiana's adverse claims statute required that the judgment creditor provide the bank with notice of garnishment proceedings against the depositor, notice of the unpaid amount of the judgment, sufficient information to verify the judgment defendant as its depositor and a court order authorizing the proceedings.¹⁶⁵ Once the creditor has provided the bank with the information required by statute, the bank is required to restrict withdrawal of deposits by the judgment debtor, not to exceed the unpaid amount of the judgment.¹⁶⁶ The freeze continues for a maximum of sixty days pending the court's determination of the judgment creditor's rights to garnish the deposits.¹⁶⁷

The court in *Jones* correctly observed that the adverse claims statute is silent as to the due process rights of the judgment defendants. The statute lacks any requirements of prompt notice of the garnishment, or of notice that exemptions may be claimed pursuant to Indiana and federal statutes. Nor does the statute provide depositors with the opportunity for a prompt hearing for the purpose of identifying exempt funds. However, the court in *Jones* failed to consider the provisions of Trial Rule 69(E)¹⁶⁸ which governs the procedure for implementation of the adverse claims statute, and instead, examined only the adverse claims statute in isolation. Under Trial Rule 69(E), the proceedings supplemental may only be instituted upon a showing that the judgment creditor is the owner of a judgment against the defendant, and that the creditor has no knowledge of property of the defendant which will satisfy the judgment.¹⁶⁹ This procedure must be instituted by verified motion or accompanied by an affidavit, and conducted under judicial supervision.¹⁷⁰ A hearing must be conducted not less than twenty days after service.¹⁷¹ Indiana's statutory garnishment scheme is by design merely a continuation of the original cause and assumes that the judgment defendant has a duty to pay the plaintiff or inform him of assets available for execution.¹⁷²

163. IND. CODE §§ 34-1-44-1 to -8 (1988).

164. 701 F. Supp. at 1421.

165. IND. CODE § 28-1-20-1.1 (1988).

166. *Id.*

167. *Id.*

168. IND. R. TR. P. 69.

169. *Id.*

170. *Id.*

171. *Id.*

172. See *Civil Code Study Commission Comments*, State of Indiana (1969), reprinted in C. THOMPSON, INDIANA FORMS OF PLEADING & PRACTICE, ¶ 69.03 (1989).

The court in *Jones* also failed to consider the state's interest in facilitating the enforcement of judgments or the creditor's interest in pursuing execution of its judgment. The opinion, rather, focuses almost entirely on the historical requirements of due process, notice of the action and opportunity to be heard. Indiana's statutory scheme for proceedings supplemental to execution provided many safeguards of procedural due process established by the United States Supreme Court and other opinions considering this issue. The application for garnishment proceedings is made under oath or by verified motion and is the subject of judicial supervision.¹⁷³ Trial Rule 69(E) further requires that the motion, along with the order to appear and interrogatories, be served upon the defendant in accordance with Trial Rule 5.¹⁷⁴

The court in *Jones* was faced with a statutory scheme not unlike the Florida scheme considered in *Brown*,¹⁷⁵ although *Brown* dealt with the garnishment of wages. These cases, however, illustrate a fundamental difference in the treatment of exemptions under Florida and Indiana law. Under Florida law, the defendant is entitled to file an affidavit challenging the wage garnishment and to a prompt hearing on its claim.¹⁷⁶ The court in *Brown* found this procedure to be a significant factor in preserving procedural due process.¹⁷⁷ On the contrary, Indiana had no statutory scheme to preserve and advocate exemptions under federal and state law in conjunction with bank garnishments, although both banks involved in *Jones* voluntarily released the accounts upon verified motions to the court of the exempt nature of the garnished deposits. *Jones* was thus deprived of his exempt benefits for seventeen days, and *Long* was deprived of his benefits for eleven days. In both cases, the court promptly dissolved the garnishment orders upon the necessary showing.

The court in *Jones* correctly detailed the flawed nature of Indiana's postjudgment garnishment procedure. Neither *Jones* nor *Long* were advised of their rights to claim exemptions under Indiana and federal law, nor was a statutory scheme available to implement the claimed exemptions. These results are particularly harsh on the elderly and disadvantaged population which are dependent on social security or other governmental benefits for their existence. The constitutional requirements of procedural due process mandate that adequate notice be provided to such individuals and an immediate hearing be scheduled for the purpose of establishing exempt benefits. The court limited its holding to funds kept in bank

173. IND. R. TR. P. 69.

174. *Id.*

175. 539 F.2d 1355 (5th Cir.), *cert. denied*, 430 U.S. 949 (1976).

176. FLA. STAT. ANN. § 222.12 (West 1967).

177. 539 F.2d at 1365.

accounts or with trust companies or other financial institutions.¹⁷⁸ *Ex parte* postjudgment seizures of other non-liquid assets were not affected.¹⁷⁹

IV. INDIANA'S LEGISLATIVE RESPONSE

The publication of *Jones* on December 6, 1988 caused considerable confusion in the trial courts of Indiana which were engaged in postjudgment garnishment proceedings. A number of courts published their own bank garnishment forms which included lengthy recitals regarding the defendant's right to claim exemptions as well as a right to a prompt hearing upon request. The confusion was relieved on May 5, 1989, with the passage of House Enrolled Act No. 1031 which substantially amended Indiana Code section 28-1-20-1.1 and enacted the Depository Financial Institutions Adverse Claims Act (the "Act").¹⁸⁰

The Act cures the constitutional deficiencies of the prior adverse claims statute identified in *Jones* and provides clear procedural guidelines for the garnishment of bank deposits. Chapter 3 of the Act¹⁸¹ addresses the issue of notice and retains many elements of the prior adverse claim statute relating to information provided to the financial institution. However, the Act has added substantial notice requirements which must be provided if the judgment defendant is an individual.¹⁸² The court

178. 701 F. Supp. at 1420.

179. *Id.*

180. Pub. L. No. 258-1989, Sec. 2, 1989 Ind. Acts 1869 (codified at IND. CODE ANN. §§ 28-9-1-1 to -5-3 (West Supp. 1989)).

181. IND. CODE ANN. §§ 28-9-3-1 to -5 (West Supp. 1989).

182. IND. CODE ANN. § 28-9-3-4(b) (West Supp. 1989) provides:

A depository financial institution may not be held accountable to an adverse claimant for funds in a deposit account that are claimed by the adverse claimant unless the adverse claimant has done all of the following:

(1) Provides the depository financial institution notice of garnishment proceedings, the unpaid amount of the judgment, and sufficient identifying information about the judgment defendant to enable the depository financial institution reasonably to verify the judgment defendant as the depositor.

(2) Serves or causes to be served upon the depository financial institution an order to answer interrogatories.

(3) If the judgment defendant is an individual, serves or causes to be served upon the depository financial institution a copy of a notice, or an apparently valid order containing a notice, issued by a court that is directed to the judgment defendant (which is to be used by the depository financial institution to comply with I.C. 28-9-4-2(a)(2)) and that:

(A) states that the adverse claimant has or may have served or caused to be served upon one(s) or more depository financial institutions notice that may result in the placing of a hold on deposit accounts maintained by the judgment defendant, either individually or jointly with another person, in such depository financial institutions;

must now notify the defendant that a hold may be placed on his account and that various exemptions may be available under federal and state law.¹⁸³ The notice must also state that the defendant is entitled to a prompt hearing to present evidence and establish statutory exemptions.¹⁸⁴ A pre-printed detachable form must be included with the notice to expedite the defendant's request for hearing.¹⁸⁵ The Act emphasizes the importance of notice by requiring information about exemptions and the opportunity for hearing to be conspicuous, either by capitalization, printing format or contrasting color.¹⁸⁶ A form which complies with the

(B) states that under federal and state law certain funds are exempt from garnishment including Social Security, Supplemental Security Income, veterans benefits, certain disability pension benefits, and benefits under any pension paid from a trust qualified under the Employee Retirement Income Security Act of 1974, and that there may be other exemptions from garnishment under federal or state law;

(C) states that if the judgment defendant or another person who maintains a deposit account jointly with the judgment defendant believes that some or all of the funds in the deposit account on which a hold may have been placed are exempt, such person is entitled to a prompt hearing for the purpose of presenting evidence to establish exemptions and seeking removal of the hold; and

(D) has attached to it a preprinted detachable form that may be used by the judgment defendant or other person maintaining a deposit account jointly with the judgment defendant in requesting the prompt hearing specified in clause (C) and that generally instructs such person as to how the form should be used in requesting this hearing.

(4) Serves or causes to be served upon the depository financial institution an apparently valid order issued by a court that expressly directs the depository financial institution to place a hold on a deposit account identified in the order whenever the conditions under subdivision (1) through (3) are met.

183. IND. CODE ANN. § 28-9-3-4 (West Supp. 1989).

184. *Id.*

185. *Id.*

186. IND. CODE ANN. § 28-9-3-5(b) (West Supp. 1989) provides:

Use of the following forms will constitute compliance with the notice requirements of section 4(b)(3) of this chapter:

**NOTICE OF CERTAIN EXEMPTIONS
AND YOUR RIGHT TO A PROMPT HEARING**

It may be that the plaintiff has or will give notice to your bank or other persons holding property or assets for you of the intent to put a hold on certain accounts held by you, either individually or jointly with another person, including, but not limited to bank, share, and credit union accounts. Under Indiana law, this notice may already have resulted in the placing of a hold on those accounts. **UNDER FEDERAL AND STATE LAW, CERTAIN FUNDS ARE EXEMPT FROM GARNISHMENT. THIS MEANS THAT THESE FUNDS MAY NOT BE TAKEN BY CREDITORS EVEN IF THEY HAVE BEEN DEPOSITED INTO YOUR ACCOUNTS. SOCIAL SECURITY, SUPPLEMENTAL SECURITY INCOME, VETERANS BENEFITS, CERTAIN DISABILITY PENSION**

requirements of the Act is included.¹⁸⁷ The Act requires the depository institution to place a hold on the account described in the notice.¹⁸⁸ The

BENEFITS, AND BENEFITS UNDER ANY PENSION PAID FROM A TRUST QUALIFIED UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 CANNOT BE TAKEN. THERE MAY BE OTHER EXEMPTIONS UNDER STATE OR FEDERAL LAW. IF YOU OR ANOTHER PERSON WHO MAINTAINS A JOINT ACCOUNT WITH YOU BELIEVE THAT ALL OR SOME OF THE FUNDS IN THESE ACCOUNTS ARE EXEMPT, YOU OR YOUR JOINT DEPOSITOR ARE ENTITLED TO A PROMPT HEARING IN THIS COURT TO PRESENT EVIDENCE TO ESTABLISH EXEMPTIONS AND TO SEEK REMOVAL OF THE HOLD.

To obtain such a hearing, fill in the form marked "Exemption Claim and Request for Hearing" attached hereto and return it to this court either by mail or by personally bringing it to the court. A copy of that form should also be sent to plaintiff's attorney or to the plaintiff, if the plaintiff is not represented by an attorney, at the address set forth below. A prompt hearing will be scheduled by the court as soon as possible, but generally no later than 5 days (excluding Saturdays, Sundays, and legal holidays) after the completed form is received by the court. Please call the court at (____) ____ to find out when the hearing is scheduled. When calling the court, please have the cause number handy. The cause number is located at the top of the right-hand side of this document. After the hearing, the court will decide whether all or part of the funds in each account on which a hold has been placed or other accounts in which you have an interest may be taken by the plaintiff.

If a joint depositor or you do not request an early hearing, there will be a hearing at the time when you are ordered to appear. At that hearing, you and a joint depositor are entitled to assert any exemptions. However, if a joint depositor or you do not request an early hearing, each account on which a hold has been placed may not be released until the time you are ordered to appear.

EXEMPTION CLAIM AND REQUEST FOR HEARING RETURN THE HONORABLE JUDGE OF THE RETURN COURT OF _____ COUNTY.

ROOM NO. _____

(Address)

(City, State, Zip)

Re: Cause No. _____

I believe that all or part of the money in my account(s) that may have been frozen cannot be frozen since the account (s) contain exempt funds. I would like a hearing at the earliest time.

(Signature)

Check One:

- I am the judgment defendant.
 I maintain a joint account with the judgment defendant.

187. *Id.*

188. IND. CODE ANN. § 28-9-4-2(a)(2) (West Supp. 1989).

statute also extended the time of restriction on withdrawal from an account to ninety days,¹⁸⁹ over the sixty days prescribed by the prior statute.

Chapter 4 of the Act addresses the obligations of the financial institution upon receipt of the required notice.¹⁹⁰ The financial institution is now entitled to deduct a garnishment fee of \$30.00 or the amount of funds on deposit, whichever is less.¹⁹¹ The financial institution is then required to restrict withdrawals for the accounts in the amount of the judgment within a "commercially reasonable time" after service.¹⁹² If the account is owned by a defendant who is an individual, the institution must forward to the depositor within one working day of the hold a notice which complies with the provision of Indiana Code section 28-9-3-4(b)(3).¹⁹³

V. CONCLUSION

The Supreme Court first recognized that procedural due process must necessarily be applied to protect property interests affected by garnishment proceedings in *Sniadech v. Family Finance Corporation*¹⁹⁴ issued in 1969. In numerous opinions issued after *Sniadech*, the Supreme Court continued to develop and refine requirements of procedural due process in various auxiliary proceedings, including prejudgment garnishment,¹⁹⁵ replevin,¹⁹⁶ and sequestration,¹⁹⁷ as well as administrative proceedings.¹⁹⁸ Although the Supreme Court has not considered the precise requirements of procedural due process in postjudgment garnishment proceedings since its 1924 opinion in *Endicott-Johnson Corp. v. Encyclopedia Press, Inc.*,¹⁹⁹ an increased level of constitutional protection under such circumstances is justified under circumstances involving state and federal exemption statutes.²⁰⁰

The state court's order freezing bank deposits which were exempt under federal law contributed substantially to the court's opinion in *Jones*.²⁰¹ Indiana's bank freeze statute failed to meet the requirements

189. *Id.* § 28-9-4-2(b).

190. *Id.* § 28-9-4-2.

191. *Id.* § 28-9-4-3(b).

192. *Id.* § 28-9-4-2(a)(2).

193. *Id.* § 28-9-4-2(a)(3).

194. 295 U.S. 337 (1969).

195. *North Georgia Finishing, Inc. v. Di-Chem, Inc.*, 419 U.S. 601 (1975).

196. *Fuentes v. Shevin*, 407 U.S. 67 (1972).

197. *Mitchell v. W. T. Grant Co.*, 416 U.S. 600 (1974).

198. *Matthews v. Eldridge*, 424 U.S. 319 (1976).

199. 266 U.S. 285 (1924).

200. *Finberg v. Sullivan*, 634 F.2d 50, 56-57 (3rd. Cir. 1980).

201. 701 F. Supp. 1414 (S.D. Ind. 1988).

of procedural due process since it did not provide for notice to the garnishee defendant of allowable exemptions or a prompt hearing to identify these funds.²⁰² Indiana's new Depository Financial Institution Adverse Claims Act²⁰³ addresses the requirements of procedural due process described in *Jones* and identifies a specific procedure for the practitioner to use in post judgment garnishment proceedings. In addition, the Act establishes a sound procedural framework to avoid the harsh and unjust results which occurred under Indiana's prior law. Ultimately, the Act provides adequate safeguards against arbitrary or erroneous seizures, while representing a fair accommodation of the respective interests of debtor and creditor.

202. 701 F. Supp. at 1420.

203. IND. CODE ANN. §§ 28-9-1-1 to -5-3 (West Supp. 1989).

Survey of Recent Developments in the Indiana Rules of Trial Procedure in Civil Matters

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I. INTRODUCTION

Each civil case which is litigated within the framework of the Indiana Rules of Trial Procedure ("Trial Rule[s]" or "Rule[s]") necessarily involves procedural issues and the application of those Rules. This Survey, however, is limited to those reported decisions within the survey period which involved the interpretation of the civil Trial Rules in some particular and important way by the Indiana appellate courts. A brief overview is also made of amendments which were enacted during the survey period to those Rules affecting appellate practice. Cases decided during the survey period which have involved noteworthy interpretations of the Federal Rules of Civil Procedure are addressed elsewhere in this survey edition.

II. THE RIGHT TO TRIAL BY JURY

The application of Trial Rule 38(A) was examined several times during the survey period. Rule 38(A) entitles a party to a jury trial as a matter of right, where such a right existed prior to June 18, 1852.¹ Traditionally, the rule in Indiana has therefore been that actions in equity create no right to a trial by jury, while those in law, do.² This distinction was addressed during the survey period by the Indiana Court of Appeals in *Howell v. State Farm Fire & Casualty Co.*,³ a first-party action by insureds against their insurer for the recovery of compensatory damages for damage to property and for the recovery of punitive damages. The plaintiffs also demanded trial by jury. State Farm in its answer raised various affirmative defenses, and sought, by counterclaim, to have the policy rescinded or cancelled based upon the alleged misrepresen-

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1. IND. R. TR. P. 38.

2. *Hiatt v. Yergin*, 152 Ind. App. 497, 513, 284 N.E.2d 834, 843 (1972).

3. 530 N.E.2d 318 (Ind. Ct. App. 1988). Nowhere in the reported opinion does the court of appeals specifically state that the insured timely made a jury trial demand either with respect to the original complaint or with respect to defense of the counterclaim. A jury trial, having been demanded, is inferred only from the court's statement of the issue on appeal ("Whether the trial court reversibly erred in denying [the appellants] a trial by jury"). *Id.* at 319, and by the ensuing discussion within the opinion.

tations of the insureds. The trial court refused the plaintiffs' jury trial demand with respect to the trial of the defendant's counterclaim, and after a trial to the court, found in favor of State Farm and apparently rescinded the policy.⁴

After correctly noting that the determination of whether an action lies in law or in equity can be made only by looking to the true nature of the claims and the pleadings as a whole,⁵ the court of appeals reversed the trial court and held that actions on insurance policies are actions at law, not at equity, and are therefore properly triable by jury.⁶ The court further held that a party whose jury demand is effectively denied by the trial court need not preserve error by further objection or motion.⁷ Trial Rule 39(C), the court held, "makes clear that in proceeding under Rules 38 and 39, a party may predicate error upon the court's action without motion or objection."⁸ Accordingly, the court held that the insureds did not waive their right to jury trial by failing to object to the trial court setting the matter for bench trial and by consenting to trial in a particular venue.⁹ The case was remanded back to the trial court, for trial by jury of both the original claims as well as the counterclaims.¹⁰

Similarly, in *Weisman v. Hopf-Himsel, Inc.*,¹¹ the Indiana Court of Appeals affirmed that the distinction between law and equity, in determining the essential character of an action and thereby whether it is triable by jury on demand of either party, is to be made from the true nature of the litigation and not merely from the headings or titles of the various pleadings.¹² "To determine whether or not a party is entitled to a trial by jury, Indiana courts look beyond the label given a particular action and evaluate the nature of the underlying substantive claim."¹³ The court concluded that the essence of the subject matter of the *Weisman* litigation, the foreclosure of a mechanic's lien, was equitable in nature rather than legal.¹⁴ "That the parties to the transaction disagreed as to how much compensation was due . . . does not alter the basic characterization of this action as being a cause in equity."¹⁵ Accordingly,

4. *Id.*

5. *Id.*

6. *Id.* at 320.

7. *Id.* at 321.

8. *Id.*

9. *Id.*

10. *Id.*

11. 535 N.E.2d 1222 (Ind. Ct. App. 1989).

12. *Id.* at 1229.

13. *Id.*

14. *Id.*

15. *Id.*

the court concluded that the matter was fundamentally equitable in nature and, therefore, not triable by jury.¹⁶

The *Weisman* court further rejected the contention that those claims which were fundamentally legal in nature, rather than equitable, should have been properly bifurcated from the remaining claims and tried by jury even if the equitable claims were subject to trial only to the court.¹⁷ If "an essential part of a cause of action is equitable, the rest of the case is drawn into equity."¹⁸ Accordingly, a counterclaim sounding in law must be tried in equity, if the original claim is equitable in nature.¹⁹

III. THE DISCOVERY RULES

A. Requests for Admission

The survey period produced two important appellate interpretations of Trial Rule 36. Rule 36 is technically among the "discovery rules," but the essential function of the rule is to establish known facts rather than to discover facts not known to the party propounding the requests.²⁰

An abuse of Trial Rule 36 was addressed in *Indiana Construction Service, Inc. v. Amoco Oil Co.*²¹ There, a contract between Indiana Construction and Amoco contained an indemnity provision, purportedly entitling Amoco to indemnification from Indiana Construction. An employee of Indiana Construction was injured at a construction site at the Amoco facility, and sued Amoco in federal court. Amoco settled, and then sued Indiana Construction for indemnity in state court. In its answer to that complaint, Indiana Construction asserted that the indemnity provision which was contained within the contract was void and unenforceable, citing Indiana Code section 26-2-5-1.²² Indiana Con-

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* This author has been unable to find Indiana authority addressing the reverse proposition, that is, whether all claims are triable by jury when the essence of the original claim is legal while the essence of the counterclaim is equitable. See also *Jones v. Marengo State Bank*, 526 N.E.2d 709 (Ind. Ct. App. 1988), also decided during the survey period, holding that if an essential part of the cause of action is equitable, the case in its entirety is drawn into equity.

20. IND. R. TR. P. 36; See, e.g., *F.W. Means & Co. v. Carstens*, 428 N.E.2d 251, 256 (Ind. Ct. App. 1982).

21. 533 N.E.2d 1300 (Ind. Ct. App. 1989).

22. (Burns Supp. 1989) (statute declares void and unenforceable, as against public policy, indemnity provisions contained in construction or design contracts except those pertaining to highways, which purport to indemnify the indemnitee against the indemnitee's sole negligence).

struction, the defendant, then propounded to Amoco a series of Rule 36 requests for admission, one of which erroneously requested that Amoco admit that the injuries sustained by the original plaintiff-employee "were sustained as a result of the sole negligence or willful misconduct of Indiana Construction Service, Inc.,"²³ rather than having requested that the injuries were sustained as a result of the sole negligence of Amoco. Amoco then admitted the request; that is, admitted that the injuries to the original plaintiff were caused solely by the negligence of Indiana Construction Service, Inc., as the plaintiff in the indemnity action, and then moved for summary judgment based upon that admission. The trial court thereafter denied Indiana Construction's motion to withdraw Amoco's admission, and granted summary judgment in favor of Amoco. The appeal ensued.

The court of appeals properly reversed the summary judgment. The appellate court observed that the request had been mistakenly drafted to identify Indiana Construction as the negligent party, rather than the intended party, Amoco. While an admission of a Rule 36 request binds the party *answering* the request, and thereby establishes the fact requested *as against the party answering*, "the mere propounding of these requests admits nothing as to the *requesting party*."²⁴ Because Indiana Construction, the party *propounding*, but *not answering* the requests, never admitted it was negligent, the court of appeals reasoned that the admissions by Amoco did not establish negligence against Indiana Construction.²⁵ Distinguishing stipulations from requests for admissions, the court of appeals concluded that "[a]n admission does not have the effect of a stipulation, even though T.R. 36 provides matters admitted under that rule are conclusively established."²⁶

*Shoup v. Mladick*²⁷ provided the court of appeals with further opportunity to interpret Trial Rule 36 during the survey period. In a medical malpractice action against two physicians, physician A admitted in a response to a request for admission propounded by the plaintiffs

23. *Indiana Constr. Serv.*, 533 N.E.2d at 1301.

24. *Id.*, (emphasis supplied). It is respectfully submitted that Trial Rule 1 provided the court of appeals with an additional basis for extending relief from what unquestionably was an unintentional error in the drafting of the request. Trial Rule 1 states that the Rules which "govern the procedure and practice in all courts, in all suits of a civil nature . . . shall be construed to secure the just, speedy, and inexpensive determination of every action." IND. R. TR. P. 1. Neither the court's entry of summary judgment, nor Amoco's apparent opposition to the effort by Indiana Construction to withdraw the admission, are consistent with the intended policy of the supreme court in the promulgation of Trial Rule 1.

25. *Indiana Constr. Service*, 533 N.E.2d at 1301.

26. *Id.*

27. 537 N.E.2d 552 (Ind. Ct. App. 1989).

that the co-defendant, physician B, had breached the appropriate standard of care. Physician B thereafter received a unanimous medical review panel decision that he was not negligent. Physician B then initiated summary judgment proceedings based upon the unanimous decision of the medical review panel.²⁸ In opposition to physician B's motion for summary judgment, the plaintiffs argued that the summary judgment must be defeated based upon the assertion by physician A in *his* answers to the plaintiffs' request for admission that physician B was negligent. In upholding the summary judgment of the trial court in favor of physician B, the court of appeals correctly determined that requests for admission of facts addressed to one defendant, physician A, are not binding upon a co-defendant, physician B. “[Trial Rule] 36 admissions,” the court held, “apply to and bind [only] the answering party, not a co-defendant.”²⁹

B. Pretrial Discovery

Brown v. Terre Haute Regional Hospital,³⁰ addressing the issue of what sanctions may be imposed for the violation of the discovery rules, reaffirmed the right of the trial courts to exclude trial evidence offered by a party who has violated those rules. In *Brown*, three violations of the discovery rules preceded, and served as the basis for, the exclusionary ruling: (1) the plaintiff did not seasonably supplement discovery responses under Trial Rule 26(E); (2) the plaintiff divulged two additional expert witnesses only several days before trial; and, (3) the plaintiff failed to cause an important expert witness to disclose all of that expert witness' opinions in a discovery deposition, even though the trial court had specifically ordered the plaintiff to require that expert to disclose any and all new expert opinions prior to trial.³¹ In fact, the trial court had granted the defendant a continuance, once the additional expert witness was identified by the plaintiff shortly before trial, in order to discover all of the expert testimony of that witness pursuant to a discovery deposition.³²

Trial Rule 26(E)(1) is self-operative, requiring the supplementation of discovery responses without court order or resubmission of the discovery requests, concerning the identity and location of persons having

28. Failure by a plaintiff to provide admissible expert opinion sufficient to contradict a unanimous medical review panel finding in favor of the health care provider warrants the entry of summary judgment in favor of the provider. *Ellis v. Smith*, 528 N.E.2d 826 (Ind. Ct. App. 1988).

29. *Shoup*, 537 N.E.2d at 553.

30. 537 N.E.2d 54 (Ind. Ct. App. 1989).

31. *Id.* at 58.

32. *Id.*

knowledge of discoverable matters as well as the identity of expert witnesses, the subject matter of the expected testimony of those experts, and the substance of that expert testimony.³³ In *Brown*, the plaintiff complied neither with that rule nor with the court order specifically instructing the plaintiff to disclose, during the deposition of the expert witness, all new expert opinions which had not previously been disclosed.³⁴ When, during trial, the plaintiff sought to elicit an opinion from that expert witness which had not been previously disclosed during the defendant's discovery deposition of that witness, the trial court properly prohibited that testimony from being presented to the jury. The court of appeals affirmed the exclusionary ruling as a proper exercise of the discretion of the trial court in imposing appropriate discovery sanctions.³⁵

In *DeMoss Rexall Drugs v. Dobson*,³⁶ the court of appeals addressed the discovery issue of whether pre-suit statements obtained by an insurer from its own insured during the investigation of a potential third-party claim against the insured are discoverable once suit is filed against the insured. The defendant had resisted the production of those statements based upon the argument that they were protected either as privileged communication or as part of the work-product doctrine, recognized in Trial Rule 26(B)(3).³⁷

The essential facts of the case were that on September 14, 1987, the potential plaintiff went to the defendant's pharmacy to have a prescription filled.³⁸ The prescription was filled with an incorrect medication, presumably because of error by the pharmacist. The plaintiff thereafter developed adverse reactions to the incorrect medication. On Friday, September 25, 1987, the pharmacy reported the potential claim to its insurer. On the following Monday, three days later, the insurer concluded that this was a potentially difficult claim, and that the claimant had a proven history of presenting at least one other previous claim.³⁹ Less than two weeks later, on October 5th and 6th, the insurer obtained recorded statements from its insured, including the insured pharmacist.

33. IND. R. TR. P. 26(E)(1).

34. 537 N.E.2d at 57.

35. *Id.* at 58.

36. 540 N.E.2d 655 (Ind. Ct. App. 1989).

37. *Id.* at 657. *DeMoss* is a case of first impression in Indiana on the issue of whether a third-party is entitled to discover the investigative materials prepared by the defendant's insurer. The *DeMoss* court relied upon *CIGNA-INA/Aetna v. Hagerman-Shambaugh*, 473 N.E.2d 1033 (Ind. Ct. App. 1985), which had allowed discovery of such materials in a first-party action by an insured against the insurer in a bad-faith action. For the reasons set forth hereinafter, this author believes that the extension of *CIGNA* to the arena of third-party litigation is unsound.

38. *Id.* at 656.

39. *Id.*

The trial court subsequently ruled, once suit was filed, that those pre-suit statements were discoverable by the plaintiff.⁴⁰

The court of appeals concluded that the trial court had not abused its discretion in requiring the production of those statements.⁴¹ Because all privileges bearing upon the rights of discovery in Indiana are statutory in nature, and their creation is solely within the prerogative of the legislature, the court of appeals reasoned that there is no insurer-insured privilege in Indiana unless one is created by legislation.⁴² The court concluded, therefore, that the discoverability of the insured's statements was unprotected by any claim of insurer-insured privilege.⁴³

Finding no privilege, the court of appeals then considered the second basis for the insurer's objection to the production of the statements, namely, that the insured's statements were "prepared in anticipation of litigation," the prerequisite for the work product protection under Trial Rule 26(B)(3). In evaluating that contention, the court declined to accept the insurer's position that all documents prepared by insurers are immune from discovery under the protection of work product,⁴⁴ noting that even under the landmark United States Supreme Court holding in *Hickman v. Taylor*,⁴⁵ unprivileged facts obtained by an attorney are freely discoverable so long as they were obtained prior to, or for a purpose other than, anticipation of litigation, and only those facts which are actually obtained by counsel in anticipation of litigation enjoy the conditional work product protection of being discoverable upon a showing of need and unavailability.⁴⁶ The court of appeals thereby declined to grant the insurer a greater protection with respect to its work product than legal counsel is entitled to with respect to counsel's own work product under *Hickman v. Taylor*. Relying upon, and reaffirming, *CIGNA-INA/Aetna v. Hagerman-Shambaugh*,⁴⁷ the court of appeals concluded that while some insurance investigations are conditionally protected by the work product doctrine, others are not; those which truly are "prepared in anticipation of litigation," the court concluded, are protected, while those which are not obtained in anticipation of litigation, but are merely routine in nature, fall beyond the work product pale of protection and

40. *Id.*

41. *Id.* at 659.

42. *Id.* at 657.

43. *Id.* The court acknowledged that there may be policy considerations favoring an evidentiary exclusion rule for communications between an insured and its insurer, citing *Snodgrass v. Baize*, 405 N.E.2d 48, 54 (Ind. Ct. App. 1980), but deferred to the legislature for creation and protection of such a privilege. *Id.*

44. *Id.*

45. 329 U.S. 495 (1947).

46. *DeMoss*, 540 N.E.2d at 657.

47. 473 N.E.2d 1033 (Ind. Ct. App. 1985).

become freely discoverable even without the prerequisite showing of substantial need and unavailability under Trial Rule 25.⁴⁸

In attempting to define and distinguish documents which are prepared in anticipation of litigation from those which are not, the court then purportedly fashioned a "purpose test": "[I]f the document can fairly be said to have been prepared or obtained *because of the prospect of litigation* and not, even though litigation may already be a prospect, because it was generated as part of the company's regular operating procedure,"⁴⁹ then the document is conditionally protected by the work product doctrine and becomes subject to adversarial discovery only upon a showing of need and unavailability. Applying that test, the court concluded that the statements in question had *not* been obtained *because* of litigation, but instead had been obtained by the insurer merely as the product of its regular operating procedures and were, therefore, discoverable.⁵⁰ The facts which appeared to have influenced the court in reaching its conclusion that the statements obtained by the insurer from its own insured were obtained as part of "regular operating procedures" rather than "in anticipation of litigation" were: (a) the statements had been obtained by the insurer from its insured less than two weeks after the insurer was notified of the claim; (b) the investigation had just begun when the statements were obtained; and, (c) the insurer had not yet decided to refuse to pay the claim prior to the insurer obtaining the statements.⁵¹

Certainly, standards enumerated by the courts which must then be applied to essentially fact-sensitive inquiries present the potential for incorrect application as those standards are then applied to particular sets of facts. Such will be the case when other courts apply *DeMoss* in the future. That is because the factual criteria utilized by the *DeMoss* court are not in fact determinative, nor even altogether relevant, as to whether an insurer's investigation truly is being performed *because of* the prospect of litigation or, conversely, whether such investigation is "merely" being performed as part of routine, regular investigations. The criteria used by the court to distinguish between that investigation which

48. *DeMoss*, 540 N.E.2d at 658. This author suggests that a preferred approach derives from *Almaguer v. Chicago, Rock Island & Pac. R.R.*, 55 F.R.D. 147 (D. Neb. 1972); *Ashmead v. Harris*, 336 N.W.2d 197 (Iowa 1983); and *Fireman's Fund Ins. Co. v. McAlpine*, 120 R.I. 744, 391 A.2d 84 (1978). These cases correctly disallowed discovery of an insurer's investigation work in a third-party action, on the common basis that the "seeds of litigation have been sown" once the insured reports the occurrence to his insurer, which triggers the commencement of the defense.

49. *DeMoss*, 540 N.E.2d at 658 (emphasis supplied).

50. *Id.*

51. *Id.*

is merely "regular operating procedure" from that which is truly "prepared in anticipation of litigation" is, in fact, fictitious. In reality, the only true reason for an insurer undertaking the investigation of any claim is *because of* the prospect of litigation; once a claim is presented, essentially all investigation which the insurer performs is *because of* that very "prospect of litigation." Due to that prospect, and because of the fact that insurers, by the very essence of their business and existence, are regularly involved in the "routine" business of the investigation of prospective litigation as part of the obligations to their insureds which arise from the insurance contract, the insurer establishes "regular operating procedures" to obtain sufficient information with which to assess the potential liability to its insured, which is represented by the claim asserted and by the reality of prospective litigation which that claim represents.

Likewise, whether or not the insurer has yet decided to decline payment of the claim seems questionable as a determinative element of whether investigation is being pursued because of the prospect of litigation. It is the claim itself which represents the prospect of litigation, not the insurer's decision to decline voluntary payment of that claim. In practice, a decision "to pay a claim" is further conditional upon whether the monetary valuation of the liability, and not merely the existence of the liability itself, can be mutually agreed upon rather than resolved by the actual filing of a lawsuit. Whether or not a decision has yet been made by the insurer to "accept" the claim, or not "to pay the claim," therefore, is realistically of little value in distinguishing *why* the insurer is investigating the claim, and it is that determination which the *DeMoss* court fails to articulate and satisfactorily define.⁵²

In practice, *DeMoss* may operate to discourage cost effective and sound insurance claims practices, instead creating less efficient and more expensive practices which are necessitated in order to better insulate investigation by the insurer from subsequent discovery once suit is filed. For example, if investigation which is performed by the insurer after the claim is denied is more likely to be protected from discovery than that which is performed before a decision has been made to deny the claim, as the *DeMoss* opinion would suggest, an incentive to the insurer

52. Because *DeMoss* concluded that the insurer's statements obtained from its own insureds were not work product, 540 N.E.2d at 658, the court was not required to address the next question; that is, whether the plaintiff had established the dual prerequisites under IND. R. Tr. P. 26(B)(3) of substantial need and inability without undue hardship "to obtain the substantial equivalent of the materials by other means." This author suggests that those foundational prerequisites could not easily be satisfied if the plaintiff could otherwise proceed with the discovery from the insured defendant by way of depositions, interrogatories, and other discovery procedures.

is created to deny claims outright before commencing the investigation of a claim. The result may be increased litigation.

Likewise, the retention of legal counsel by the insurer in the early stages of the investigation, and the involvement by that counsel in the fact gathering process, would seem to produce relevant evidentiary proof that the investigation is being performed because of the prospect of litigation rather than as a routine exercise of insurer operations. Litigation costs may thereby increase in order to better protect the insurer's ability to conduct nondiscoverable investigation prior to suit being filed. In short, the criteria of the court for establishing protected discovery may result in additional litigation cost to the insurance industry, and ultimately to the public which that industry serves, without truly establishing relevant *factual criteria* for distinguishing discoverable, "routine" investigation from that which is investigation obtained only in anticipation of litigation and, therefore, undiscoverable unless the dual criteria of substantial need and unavailability can be established.

It is suggested that the court of appeals should distinguish unprotected, routine investigation from protected discovery performed in anticipation of litigation by requiring an inquiry as to the *ultimate purpose* of the investigation rather than merely focusing on the particular stage or status of the claim when the controverted discovery has been conducted. If the ultimate purpose of the insurer in performing particular discovery or investigation is to obtain information because of the reasonable prospect of third-party litigation, which is initially represented by the notice of a potential claim and the occurrence of an event which has given rise to that claim, whether or not the claim has yet been denied, then the product of that investigation should be conditionally protected as having been obtained "in anticipation of litigation or of trial" and, thus, within the conditional work product protective pale. Under such a test, the free flow of information at least between an insurer and its own insured in the pre-suit investigation phase of a claim would be unfettered by the prospect of unnecessary subsequent disclosure. The insurer thereby would not be discouraged from performing investigation which the prospect of litigation requires but which may produce information adverse to the interests of its own insured, and to its own interests, in the ultimate disposition of the claim.

Under such an "ultimate purpose" standard, the information obtained for the purpose of evaluating a claim in anticipation of litigation would still remain discoverable upon the satisfaction of the showing of need and unavailability. Yet the insurer is provided the conditional protection needed for frank and complete claims investigation and evaluation, which are both the right and the duty of the insurer under the contract of insurance with its insured. *DeMoss*, as part of the unfortunate

progeny of *CIGNA-INA/Aetna v. Hagerman-Shambaugh*,⁵³ impairs those procedures and rights unnecessarily. Certainly statements which investigators may have obtained on behalf of a plaintiff as part of the "routine" investigation prior to counsel reaching a final decision on whether or not to file suit, and especially statements given to those investigators directly by the plaintiff, should not be discoverable work product by the defense absent at least the foundational showing of the absence or waiver of a privilege or of substantial need and other unavailability of that information. In turn, the investigation which an insurer performs in order to protect its own insured, and especially statements obtained from its own insured within the contractual relationship of the policy of insurance, should enjoy no less work product protection against compulsory disclosure once suit is filed. *DeMoss* should be reconsidered.

IV. PERSONAL JURISDICTION

In *Alberts v. Mack Trucks, Inc.*,⁵⁴ the court considered the question of which party carries the burden of proof in establishing the presence or absence of personal jurisdiction once a motion to dismiss the complaint is filed pursuant to Trial Rule 12(B)(2). In *Alberts*, the plaintiff, an Indiana resident, filed suit in Indiana to recover damages arising out of a personal injury accident which had occurred in Illinois.⁵⁵ The complaint alleged that one of the defendants, Mack Truck, "is a corporation doing business in Indiana," and that the other defendant, National Seeding Company, "does business in Ohio."⁵⁶ The complaint did not allege that National Seeding had otherwise participated or engaged in any of the activities by which long-arm jurisdiction could be invoked pursuant to Trial Rule 4.4. Both defendants filed motions to dismiss for lack of personal jurisdiction under Trial Rule 12(B)(2), and the trial court granted both motions after conducting an unrecorded hearing.⁵⁷ Neither the plaintiff, nor either of the defendants, submitted any evidence by affidavit or otherwise on the jurisdictional issue which both motions addressed. After the trial court granted both motions, the plaintiff filed his motion to correct errors and, in support thereof, submitted the affidavit of his counsel pursuant to Trial Rule 59(H)(1). The affidavit, however, only contained the argument which plaintiff's counsel had presented at the unrecorded dismissal hearing; no facts were set forth in the affidavit.⁵⁸

53. 473 N.E.2d 1033 (Ind. Ct. App. 1985).

54. 540 N.E.2d 1268 (Ind. Ct. App. 1989).

55. *Id.* at 1269.

56. *Id.* at 1271-72.

57. *Id.* at 1269.

58. *Id.* at 1270.

On appeal, the court of appeals first held that counsel's affidavit which was attached to the motion to correct errors was meaningless because its content was merely the disclosure of unsworn arguments which had been made by counsel during the dismissal hearing.⁵⁹ Noting that Trial Rule 59(H)(1) permits the filing of affidavits to establish *facts* which are not reflected in the record, if the motion to correct errors is based upon evidence outside of the record, the court concluded that “[t]he unsworn commentary of an attorney is inadequate to establish facts in evidence before the court.”⁶⁰

The court next determined that Mack Trucks, as a party challenging jurisdiction in a court of general jurisdiction, had the burden of establishing the absence of adequate jurisdictional grounds *unless* the lack of that jurisdiction is apparent on the face of the complaint itself.⁶¹ At bar, the complaint in fact had alleged that “Mack Trucks, Inc., is a corporation doing business in the State of Indiana,” an allegation which the court concluded was sufficient to invoke the long-arm jurisdiction under Trial Rule 4.4.⁶² Because those allegations in the complaint were sufficient to establish a *prima facie* jurisdictional claim, and because Mack Trucks had not come forth with any evidence sufficient to contradict those jurisdictional allegations, the court concluded that Mack had failed to carry *its* burden “to at least go forward with evidence” under Trial Rule 12(B)(2) to establish the *absence* of jurisdiction.⁶³

Although concluding that Mack Truck had failed to carry its burden of coming forth with evidence to refute the claim of jurisdiction, the court reasoned that the co-defendant, National Seeding Company, had no such duty of presenting evidence in support of its Trial Rule 12(B)(2) jurisdictional motion.⁶⁴ With respect to National Seeding Company, the court noted that the complaint had only alleged that National Seeding “did business in Ohio,” and that the complaint lacked any allegation on its face of any facts sufficient to invoke jurisdiction under Trial Rule 4.⁶⁵ Accordingly, the court concluded that it was the plaintiff, and not National Seeding, which was encumbered with the burden of coming forward with evidence concerning jurisdiction.⁶⁶ Because the plaintiff had not made sufficient allegations in the complaint concerning the basis of jurisdiction against National Seeding, and further that the plaintiff there-

59. *Id.*

60. *Id.* (citing *Freson v. Combs*, 433 N.E.2d 55, 59 (Ind. Ct. App. 1982)).

61. *Id.* at 1271.

62. *Id.*

63. *Id.*

64. *Id.* at 1272.

65. *Id.*

66. *Id.*

after had not come forward with evidence to establish proof of some jurisdictional basis against National Seeding once National Seeding filed its motion to dismiss based upon the absence of jurisdiction, the court concluded that the jurisdictional motion was proper and should be granted.⁶⁷

While *Alberts* principally addressed the issue of which party has the burden of coming forward with evidence concerning the presence or absence of jurisdiction, *Omnisource Corp. v. Fortune Trading Co.*,⁶⁸ also decided during the survey period, addressed the analytical steps which must be taken for the determination of whether jurisdiction has been established under the Indiana Long-Arm Statute and what evidentiary quality must be met in order to invoke that jurisdiction. In *Omnisource*, the Fortune Company, with its principal place of business in Maryland, solicited Omnisource by telephone to sell scrap metal to Fortune. Subsequently, an oral agreement was reached between Fortune and Omnisource for the furnishing of the scrap metal. None of Fortune's representatives were ever in Indiana, all of the scrap metal was physically located outside of Indiana, and the metal was sold and shipped to Japan and Taiwan.⁶⁹

Upon the foregoing facts, the court of appeals concluded that there were sufficient minimum contacts with the state of Indiana in order to invoke the long-arm statute.⁷⁰ Specifically, the court held that a two-step jurisdictional analysis must be used.⁷¹ First, a determination must be made whether a defendant has "purposefully established minimum contacts with the forum state" and, if that condition is satisfied, the next determination is whether the assertion of personal jurisdiction also "would comport with fair play and substantial justice."⁷² The court then reviewed those factors which must be considered in determining whether, in fact, "fair play and substantial justice" have been met: (1) the nature and quality of the contacts with the forum state; (2) the quantity of contacts with the state; (3) the relationship between those contacts and the cause of action; (4) the interest of the forum state in providing a forum for its residents; and, (5) the convenience of the parties.⁷³

*Jennings v. Jennings*⁷⁴ required the court of appeals to determine whether Indiana courts could acquire *in personam* jurisdiction over a

67. *Id.*

68. 537 N.E.2d 43 (Ind. Ct. App. 1989).

69. *Id.* at 43-44.

70. *Id.* at 45.

71. *Id.* at 44.

72. *Id.* (citing *Woodmar Coin Center, Inc. v. Owen*, 447 N.E.2d 618, 621 (Ind. Ct. App. 1983)).

73. *Id.* at 44-45.

74. 531 N.E.2d 1204 (Ind. Ct. App. 1988).

foreign defendant based solely upon the Indiana residency of the plaintiff. The plaintiff and defendant were divorced in Kansas in 1980. Thereafter, the wife moved to Indiana and, in 1982, commenced child support proceedings against her former husband in an Indiana court. At that time, the husband was a resident of Illinois, and was served with the support petition and summons in Illinois by certified mail. A default judgment was subsequently obtained against him in the Indiana court. He did not participate or otherwise appear in the support proceedings.⁷⁵

In 1987, the husband then attacked the 1982 default judgment on the ground that the judgment was void because the Indiana court lacked personal jurisdiction over him, as an Illinois resident.⁷⁶ In the 1987 proceedings to set aside the default judgment, the trial court acknowledged that it in fact had lacked *in personam* jurisdiction over the defendant in the 1982 proceedings, but nevertheless held that the defendant had "waived the jurisdictional issue" because he had received notice of the 1982 hearing and proceedings and had then failed to object to those proceedings.⁷⁷ The trial court, in essence, then ruled that defective jurisdiction could nevertheless be cured by the failure to timely object.⁷⁸

The court of appeals affirmed that the trial court did not have personal jurisdiction over the defendant at the time it had entered the 1982 default, finding that the presence of the former wife and the parties' children in Indiana is not sufficient alone for an Indiana court to obtain *in personam* jurisdiction over the Illinois husband.⁷⁹ And while personal jurisdiction may be waived,⁸⁰ and would have been deemed waive here pursuant to Trial Rules 12(B)(2) and 12(H)(1) had the husband actually appeared and participated in the hearing, the court concluded that the husband had, in fact, not waived his rightful objection to personal jurisdiction by merely failing or refusing to appear and participate in the 1982 hearing.⁸¹ "A defendant is always free to ignore the judicial proceedings, risk a default judgment, and then challenge that judgment on jurisdictional grounds in a collateral proceeding."⁸²

The court further noted that although a person may be estopped from challenging a void judgment if he has used it to his benefit, there

75. *Id.* at 1205.

76. *Id.*

77. *Id.* at 1206.

78. *Id.*

79. *Id.* at 1205. The Indiana Court of Appeals observed, however, in *Persinger v. Persinger*, 531 N.E.2d 502 (Ind. Ct. App. 1987), that an Indiana court does have sufficient jurisdiction to adjudicate a marital dissolution without acquiring personal jurisdiction over the absent party. *Id.*

80. *Willman v. Railing*, 529 N.E.2d 122 (Ind. Ct. App. 1988).

81. *Jennings*, 531 N.E.2d at 1206.

82. *Id.* at 1205.

was no evidence in this case that the husband had ever ratified that judgment by using it to his advantage or had otherwise manifested any intention to treat that judgment as valid.⁸³ There was, therefore, no jurisdictional waiver by estoppel.

V. PLEADING AND PARTIES

The survey period also brought two important interpretations of the relation-back operation of Trial Rule 15. In *Waldron v. Wilson*,⁸⁴ the Indiana Supreme Court addressed the issue of whether a plaintiff, having mistakenly named individual defendants rather than the corporation which the individual defendants owned and controlled, could name that corporation as the proper defendant, under the relation-back provisions of Trial Rule 15 even after the applicable statute of limitations had expired. The individual defendants were also officers and employees of the corporation.⁸⁵

The original complaint had been filed on the last day before the two-year statute of limitations had expired, alleging that the individual defendants had committed acts of negligence. In their answer, the individual defendants essentially acknowledged that they were the correct defendants. Thereafter, the individual defendants were permitted by the trial court to amend their answer to assert that the activities in question actually were those of the corporation which they controlled, rather than their individual activities. The trial court then denied plaintiff's motion to amend his complaint to add the corporate entity as an additional defendant, ruling that the proposed amended complaint could not relate back to the date the original complaint was filed because notice to the proposed corporate defendant "came after the applicable statute of limitations had expired."⁸⁶

The Indiana Supreme Court reversed, holding that Trial Rule 15(C)(1) does not require process or that a summons be served upon the correct defendant, identified in the amended complaint, prior to the expiration of the statute of limitations.⁸⁷ "What is required is such notice of the institution of the action that the added defendant will not be prejudiced in maintaining his defense on the merits."⁸⁸ In reaching its conclusion, the court noted that service upon the new defendant would have been effective and timely had the original complaint correctly included the

83. *Id.*

84. 532 N.E.2d 1154 (Ind. 1989).

85. *Id.* at 1154-55.

86. *Id.* at 1155.

87. *Waldron*, 532 N.E.2d at 1156.

88. *Id.*

new corporate defendant rather than mistakenly identifying only the individual defendants.⁸⁹ The court further was persuaded, apparently, by the fact that the insurer of the corporate defendant had received notice prior to the expiration of the statute of limitations, and that, *ipso facto*, notice was also thereby received by the insured itself.⁹⁰

In his dissent, Chief Justice Shepard concluded that Trial Rule 15(C) literally and clearly requires that a party which is sought to be added as an additional defendant after the applicable statute of limitations has expired must have received notice of the suit "within the period provided by law for commencing the action against him," and that the facts presented to the court clearly established that the corporate defendant had not received notice of the suit prior to the expiration of the applicable statute of limitations.⁹¹

In *Smith v. McFerron*,⁹² the plaintiff was operating a motor vehicle which was rear-ended by a Pontiac Sunbird driven by James McFerron, who lived with his parents, Fredonna and Neal McFerron. The Sunbird was insured under a policy of insurance issued to Neal McFerron, as the owner of the vehicle. The complaint, timely filed, incorrectly alleged that the Sunbird was operated by Neal, rather than by James, when the accident occurred. The summons and complaint were sent by certified mail to the McFerron residence, and were accepted and signed for on behalf of Neal by Fredonna. James, the actual driver of the Sunbird when the accident occurred, became aware that his mother had received the summons and complaint that day, and that his mother had informed his father of receipt of the complaint and summons. James, furthermore, became aware that day of the substance of the allegations set forth in the complaint.⁹³

After the statute of limitations expired, Neal filed his answer, denying that he was the operator of the vehicle and identifying his son, James, as a nonparty who was responsible for the collision. The trial court refused to permit the plaintiff to amend the complaint to add James as a party defendant.⁹⁴ On appeal, the court of appeals held that the trial court had arbitrarily, and thus improperly, refused to allow the plaintiff to file an amended complaint to add James as a party defendant after the statute of limitations had expired.⁹⁵ That arbitrary refusal was deemed to be an abuse of discretion, because all of the requirements

89. *Id.*

90. *Id.*

91. *Id.* at 1158 (Shepard, C.J., dissenting, quoting IND. R. TR. P. 15(c)).

92. 540 N.E.2d 1273 (Ind. Ct. App. 1989).

93. *Id.* at 1273-74.

94. *Id.* at 1274.

95. *Id.*

of Trial Rule 15(C) had otherwise been met.⁹⁶ Relying upon *Waldron*⁹⁷ and *Czarnecki v. Lear Siegler, Inc.*,⁹⁸ the court of appeals concluded that James had in fact received actual notice of the claim within the applicable two-year statute of limitations and, therefore, within the time required by Trial Rule 15(C).⁹⁹ Accordingly, the court of appeals reversed the trial court and permitted the plaintiff to amend the complaint, after the statute of limitations had expired, holding that the filing of the amended complaint would relate back to the date on which the original complaint had been filed and thereby defeat the statute of limitations.¹⁰⁰

VI. AMENDMENTS TO THOSE TRIAL RULES RELATING TO APPEALS

Effective January 1, 1989, the Indiana Supreme Court adopted significant changes to a series of trial and appellate rules relating to the initiation and prosecution of civil appeals. Effective February 16, 1989, the court adopted a further set of rule amendments governing appeals. The February amendments superseded the January amendments. To facilitate an orderly transition to the amended rules, the court entered a March 16, 1989 order permitting appealing parties to operate under either the January 1, 1989 amendments or the February 16, 1989 amendments with respect to appeals from any judgment (or sentencing) received before January 1, 1989. The court recommended that the February 16, 1989 version be utilized. For the appeal of any judgment entered after July 1, 1989, the appeal is governed by the February 16, 1989 amendments.

The amendments to Trial Rule 59 probably represent the most significant trial rule changes during the survey period because of the central importance of this rule to the appellate process. The changes essentially convert the motion to correct errors from a mandatory procedure to an optional procedure under most circumstances. Prior to the 1989 amendments, the denial by the trial court of the motion to correct errors served as the basis for the civil appeal; the motion was required to be filed within sixty (60) days after the entry of a final judgment or an appealable final order. The praecipe was then required to be filed with the trial court, designating the content of the record of proceedings, within thirty (30) days after the court ruling on the motion to correct errors.¹⁰¹ A copy of the motion to correct errors was further required

96. *Id.*

97. 532 N.E.2d 1154 (Ind. 1989).

98. 471 N.E.2d 299 (Ind. 1984).

99. *McFerron*, 540 N.E.2d at 1275.

100. *Id.* at 1276.

101. IND. R. APP. P. 2.

to be included in the record of proceedings on appeal in all civil appeals from a final judgment.¹⁰² The appellant's brief was also generally limited to those errors which had been set forth in the motion to correct errors.¹⁰³ The motion to correct errors essentially represented the specification of errors for appeal, and errors not contained in the motion to correct errors were generally considered waived.

Under the 1989 amendments to Trial Rule 59, a motion to correct errors is no longer necessary except when a party seeks to address (1) newly discovered material evidence, including alleged jury misconduct, capable of production within thirty (30) days after final judgment which, with reasonable diligence, could not have been discovered and produced at trial, or (2) a claim that a monetary award is excessive or inadequate.¹⁰⁴ All other issues and grounds for appeal which have been preserved during trial may now be asserted and addressed directly in the appellate brief rather than in the motion to correct errors, although a motion to correct errors, at the option either of the court or of any party, may still be made under amended Trial Rule 59(B). If a motion to correct errors is filed under the amended rule, the motion need only address one or both of the grounds set forth in amended Trial Rule 59(A)(1) or (2), and all other grounds for appeal may then simply be set forth for the first time in the appellant's brief on appeal. If a motion to correct errors is filed, a statement in opposition may be filed within fifteen (15) days after service of the motion.

Amendments to Trial Rules 50 and 53.3 were also made because of the changes to Trial Rule 59. Trial Rule 50(A)(6), pertaining to directed verdicts, was amended to permit the trial court to enter a judgment on the evidence, upon its own motion, at any time before final judgment, or before the filing of the praecipe for the record of proceedings; or, if a motion to correct errors is required, then at any time before the court enters its order or ruling upon the motion to correct errors. The change made by the amendment is to provide the additional grounds for permitting the trial court, on its own motion, to enter a judgment on the evidence prior to any party filing a praecipe, in order to make Trial Rule 50(A)(6) consistent with the changes in Trial Rule 59, which eliminate the necessity of a motion to correct errors except in those cases specifically set forth therein.

Trial Rule 53.3 has been amended to provide that the pending motion to correct errors shall be deemed denied if: the trial court fails to set the motion to correct errors for hearing within forty-five (45) days after

102. IND. R. APP. P. 7.2.

103. IND. R. APP. P. 8.3.

104. IND. R. TR. P. 59.

it was filed; the trial court fails to rule on the motion to correct errors within forty-five (45) days after it was filed; the trial court fails to rule on the motion to correct errors within forty-five (45) days after the hearing thereon or within forty-five (45) days after it was filed if no hearing thereon is required. Under the previous version of Trial Rule 53.3, the denial of the motion to correct errors was deemed to be established under those same timing requirements *only* upon application of a party and not by operation of the rule itself. Former Trial Rules 53.3(e) and (f), pertaining to the obligations of the clerk to make appropriate entries concerning whether the trial court has ruled upon the motion to correct errors within the requisite time period, have been eliminated in their entirety under the 1989 amendments.

During the survey period, amendments were also made to Appellate Rules 2, 3, 4, 7.2, 8.3, and 14. This Article is limited to significant changes in trial procedure and to the Trial Rules which have occurred during the survey period, and does not address these significant changes in the appellate rules which have also occurred during the survey period. The amended appellate rules interface with the amended Trial Rules relating to preservation of grounds for appeal, and all amendments should be reviewed conjunctively by the bar and judiciary when considering issues relating to appellate procedure under the 1989 Rule amendments.

VII. CONCLUSION

The author hopes that the foregoing discussion of these noteworthy cases and Rule changes will be of assistance to the judiciary and bar in their use, application and future consideration of these cases and amended Rules.

1989 Developments in Federal Civil Practice Affecting Indiana Practitioners: Issues Of Diversity Reform; Pendent Party Jurisdiction; Summary Judgment; Impeachment by Prior Conviction; Sanctions; and Appeal

JOHN R. MALEY*

I. INTRODUCTION

Indiana practitioners litigating in federal court encountered a number of significant developments in federal civil practice last year. These changes ranged from matters of subject matter jurisdiction, to sanctions, to appeals. This Article, as the second of an annual section on federal civil practice, will highlight the more important issues in an effort to assist local attorneys in their federal civil litigation.¹

A number of developments occurred affecting the subject matter jurisdiction of the federal judiciary. Congress implemented significant changes including raising the amount in controversy requirement for diversity actions to exceed \$50,000. Also, the Supreme Court seems to have altered the standards for invoking pendent party jurisdiction. Part Two of this Article will analyze these jurisdictional issues at some length.²

The next section of the Article will briefly re-visit the area of summary judgment, which was the main focus of last year's federal practice Article.³ A sampling of Seventh Circuit opinions reveals that the local federal courts continue to embrace the warming trend towards summary judgment. However, in one case the Seventh Circuit reversed and remanded an action for the imposition of sanctions against the lawyer

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1. This is the second year that the Survey Issue has covered developments in federal civil practice. As last year's article discussed, this section of the Survey is aimed at helping Indiana practitioners keep abreast of significant developments in local federal civil practice. See Maley, *Developments in Federal Civil Practice Affecting Indiana Practitioners: Survey of Supreme Court, Seventh Circuit, and Indiana District Court Opinions*, 22 IND. L. REV. 103-04 (1989) [hereinafter Maley, *1988 Developments*]. These Articles concentrate on key decisions of the Seventh Circuit Court of Appeals, and highlight major developments at the national level as well as particularly instructive decisions of the local district courts. The focus is on federal civil practice and procedure. Substantive federal decisions and matters of criminal procedure are left to other forums.

2. See *infra* text accompanying notes 11-86.

3. See Maley, *1988 Developments*, *supra* note 1.

who sought and obtained summary judgment. This illustrates that summary judgment is a rose with some particularly nasty thorns if it is improperly used. Part Three will discuss these developments.⁴

A third area of development involves the power of federal judges to control the proceedings before them. In one case the Seventh Circuit, sitting *en banc*, decided by a sharply divided vote that a district court has the power to order a litigant to personally appear at a pre-trial conference for the purpose of discussing the posture of the case and settlement. In another case the court ruled that a "frequent filer's" access to the courthouse can be permissibly limited by establishing an executive committee to review all the plaintiff's submissions prior to accepting them for filing. These developments, which show the power of the federal judiciary to govern their proceedings, will be discussed in Part Four of this Article.⁵

The most significant ruling on federal evidence during the survey period came in *Green v. Bock Laundry Machine Co.*,⁶ in which a divided Supreme Court held that Rule 609(a) of the Federal Rules of Evidence requires the federal courts to allow impeachment of a *civil witness* with evidence of prior convictions, regardless of unfair prejudice to the witness or the party offering the testimony. This landmark decision is critical not only at trial, but should be considered by practitioners at all stages of litigation, including pre-filing investigation and forum selection. In addition, as this Article went to print, Congress was presented with a proposed amendment to Rule 609 (a) that would nullify the effect of *Bock Laundry*. Part Five of the Article will analyze the decision as well as the proposed amendment and discuss their importance to Indiana lawyers.⁷

The sanctions arena, which is the subject of frequent commentary and discussion, also deserves mention in this year's Survey. The Seventh Circuit made a number of important rulings in this area, including its *en banc* decision in *Mars Steel Corp. v. Continental Bank, N.A.*,⁸ in which the court finally established that it would apply a deferential standard of review of district court sanctions, rejecting a multi-tiered approach or a *de novo* standard used by other circuits. Other decisions of the Seventh Circuit and the local district courts illustrate the type of conduct that can lead to sanctions, and several opinions show that the Seventh Circuit, even when it does not officially sanction a lawyer, is not hesitant to criticize the failings of counsel. And, the Supreme

4. See *infra* text accompanying notes 87-144.

5. See *infra* text accompanying notes 145-52.

6. 109 S. Ct. 1981 (1989).

7. See *infra* text accompanying notes 153-69.

8. 880 F.2d 928 (7th Cir. 1989).

Court ruled that attorneys, not their law firms, are the responsible party for sanctions imposed under Rule 11. These developments will be discussed in Part Six of this Article.⁹

Finally, the Seventh Circuit addressed several issues relating to taking appeals, and the Supreme Court decided that a district court's decision on the merits is a "final decision" from which appeal has to be timely taken, notwithstanding that the party's request for attorney fees has not yet been decided. These appellate issues will be analyzed in Part Seven of this Article.¹⁰

Some of the developments that this author deems of greatest importance will be discussed at length. Other issues will merely be raised so that practitioners are aware of them. The goal is to provide a comprehensive summary of a wide range of issues while at the same time giving an in-depth analysis of a few specific matters. The result, admittedly, is a lengthy Article, but hopefully one that serves the needs of many.

II. DEVELOPMENTS IN SUBJECT MATTER JURISDICTION

A. *The Judicial Improvements and Access to Justice Act*

On November 19, 1988, President Reagan signed into law the Judicial Improvements and Access to Justice Act.¹¹ The Act touched on a number of different subjects, ranging from provisions dealing with court interpreters to arbitration to jurisdiction of the Federal Circuit. The most important developments affecting Indiana practitioners, however, came in four areas: (1) an increase in the amount in controversy requirement for diversity jurisdiction; (2) a change in citizenship (for diversity purposes) of the legal representative of estates and of infants and incompetents; (3) a simplification of the procedures for removing diversity cases from state court to federal court; and (4) a modification of venue for actions against corporate defendants.¹²

1. *The Amount in Controversy Requirement is Raised to Exceed \$50,000.*—The change in the Act that will likely have the greatest impact is the increase in the amount in controversy requirement from \$10,000 to \$50,000. In Section 201 of the Act, Congress amended section 1332 of Title 28 of the United States Code to read as follows:

9. See *infra* text accompanying notes 170-214.

10. See *infra* text accompanying notes 215-30.

11. Pub. L. No. 100-702 (Nov. 19, 1988).

12. For an excellent discussion of the entire Act, see Siegel, *Changes in Federal Jurisdiction and Practice Under the New Judicial Improvements and Access to Justice Act*, 123 F.R.D. 399 (1989).

The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of \$50,000, exclusive of interest and costs, and is between-

- (1) citizens of different States;
- (2) citizens of a State and citizens or subjects of a foreign state;
- (3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and
- (4) a foreign state, defined in section 1603(a) of this title, as plaintiff and citizens of a State or of different States.¹³

The increase to exceed \$50,000 applies to any civil action "commenced in or removed to a United States district court on or after the 180th day after the date of enactment,"¹⁴ which corresponds to actions filed on or after May 18, 1989.

One simple reason for the increase was inflation.¹⁵ The amount in controversy was last raised in 1958, when Congress adjusted the threshold from \$3,000 to \$10,000. In order to keep up with inflation, it was estimated by the American Bar Association that an increase to \$35,000 would be required simply to return, in real dollars, to the 1958 level.¹⁶ Chief Judge Grady of the Northern District of Illinois has similarly observed that the change is simply keeping pace with inflation.¹⁷

The adjustment also reflects at least some intention to reduce caseloads.¹⁸ For years there has been great debate over whether the Congress should sharply narrow or even abolish the federal courts' diversity jurisdiction, with each session seeing the introduction of at least one bill on the issue.¹⁹ The increase to \$50,000 can be viewed as a middle-of-the-road compromise, with proponents arguing that the change will result in a 40% reduction of the diversity caseload.²⁰ However, others contend that the impact will be far less, particularly in tort cases where prayers for damages are conjecture at best.²¹ The change will at least have some impact on cases such as mortgage foreclosures and general

13. 28 U.S.C.S. § 1332(a) (Law. Co-op. 1986 & Supp. 1989).

14. *Id.*

15. See H.R. 100-889 (Aug. 26, 1988), reprinted in 1988 U.S. CODE CONG. & ADMIN. NEWS 5982, 6005 [hereinafter *Legislative History*]. See also Siegel, *supra* note 12, at 408-09.

16. *Legislative History*, *supra* note 15, at 6005.

17. CHIC. DAILY L. BULL., May 17, 1989, at 1.

18. See *supra* note 15.

19. 14A C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3701, at 11-12 (2d ed. 1985) [hereinafter *WRIGHT & MILLER*].

20. *Legislative History*, *supra* note 15, at 6006.

21. Siegel, *supra* note 12, at 408.

contract claims, which often do not exceed \$50,000 in controversy.²²

The Indiana practitioner faced with possible diversity questions due to the increase can sort through the labyrinth by recalling the ten basic commandments of amount in controversy litigation, which can be summarized as follows:

1. The defense of lack of subject matter jurisdiction cannot be waived, so the court must raise it on its own motion if it appears lacking.²³
2. The burden of proof to show that the amount in controversy exceeds \$50,000 is on the party asserting jurisdiction.²⁴
3. However, the test is whether it appears to a legal certainty that the claim is really for less than the jurisdictional threshold.²⁵
4. The court may allow and examine affidavits, evidence, and even live testimony in making its ruling.²⁶
5. The amount is measured by the value of the right sought to be enforced or the value of the objective of the suit.²⁷

22. *Supra* note 17. It should be noted that as this Article goes to print, the Federal Courts Study Committee is studying the possibility of further contracting diversity jurisdiction, perhaps to cover only complex multi-state litigation, interpleader, and suits to which aliens are parties. A final report from the Committee is due out in the Spring of 1990. *See Tentative Recommendations of The Federal Courts Study Committee, summarized in 58 U.S.L.W. 2442 (Feb. 6, 1990).*

23. *See FED. R. Civ. P.* 12(h)(3), which states: "Whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action."

24. *See Gibbs v. Buck*, 307 U.S. 66, 72 (1939); *Lakeside Mercy Hosp. v. Indiana State Bd. of Health*, 421 F. Supp. 193, 200 (N.D. Ind. 1976). Thus, "in cases originally commenced in federal court, plaintiff bears this burden; in removed cases, it is on the defendant." *WRIGHT & MILLER, supra* note 19, at 19-20. It should be noted that some courts tend to write that the burden is on the defendant (or plaintiff in a removal action) to show for a legal certainty that the amount in controversy is not met. *See, e.g., Iguana Co. Ltd. Partnership v. Baltimore Center for Performing Arts*, 651 F. Supp. 1348, 1349 (D. Md. 1987). Given the relatively lenient standard for the party asserting jurisdiction, this appears to be more a matter of semantics than anything of great import.

25. *See Saint Paul Mercury Indemnity Co. v. Red Cab Co.*, 303 U.S. 283, 288-89 (1938); *Loss v. Blankenship*, 673 F.2d 942, 950 (7th Cir. 1982).

26. *See WRIGHT & MILLER, supra* note 19, at 26. The Seventh Circuit has cautioned, however, that "when the issue of jurisdictional amount is intertwined with the merits of the case, 'courts should be careful not to decide the merits, under the guise of determining jurisdiction, without the ordinary incidents of trial.'" *Loss*, 673 F.2d at 950-51 (citations omitted).

27. *See Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 347 (1977); *Local Div. 519, Amalgamated Transit Union, AFL-CIO v. LaCrosse Mun. Transit Util.*, 585 F.2d 1340, 1349 (7th Cir. 1978); *Rothery Storage & Van Co. v. Atlas Van Lines Inc.*, 609 F. Supp. 554, 555 (N.D. Ill. 1985).

6. In diversity, the federal courts must look to applicable state law to determine the value of the right to be enforced.²⁸
7. The amount in controversy is determined as of the time the action is commenced by the good faith claim of the plaintiff.²⁹
8. Punitive damages and attorney fees, if claimed and available under applicable state law, are included in the amount in controversy; costs and interest are not.³⁰
9. The amount of actual recovery is relevant only to costs.³¹
10. There are three major instances in which the amount might not be satisfied:
 - a. the contract limits recovery;
 - b. a rule of law limits recovery;
 - c. independent facts show that the amount is not met.³²

By applying these rules and locating relevant case law from the Seventh Circuit (cases dealing with the \$10,000 level are, of course, just as instructive today), the local bench and bar should be able to readily address the anticipated increase of amount in controversy issues.³³ For those whose cases are dismissed for want of subject matter jurisdiction, they can take solace in Indiana's savings clause and re-file in state court, even if the statute of limitations has otherwise expired.³⁴

28. See *Horton v. Liberty Mut. Ins. Co.*, 367 U.S. 348, 352-53 (1961).

29. See *Sarnoff v. American Home Prod. Corp.*, 798 F.2d 1075, 1078 (7th Cir. 1986); *Tising v. Flanagan*, 360 F. Supp. 283, 284 (E.D. Wis. 1973). In removal cases, the time of the removal notice governs. *Richard Schilffarth & Assoc. v. Commonwealth Equity Svc., Inc.*, 715 F. Supp. 246, 247 (E.D. Wis. 1989).

30. See *By-Prod Corp. v. Armen-Berry Co.*, 668 F.2d 956, 960-61 (7th Cir. 1982) (punitive damages); *Sarnoff*, 798 F.2d at 1078 (attorney fees). The express language of § 1332(a) excludes costs and interest from the equation. See 28 U.S.C. § 1332(a) (1982).

31. See *Rosado v. Wyman* 397 U.S. 397, 405 n.6 (1970); *Guy v. Duff & Phelps, Inc.*, 625 F. Supp. 1380, 1382 (N.D. Ill. 1985). Section 1332(b) provides that when a diversity claimant ends up obtaining less than the jurisdictional amount, the district court may deny the plaintiff an award of costs, and may actually impose costs on the plaintiff instead. 28 U.S.C. § 1332(b) (1982).

32. See *WRIGHT & MILLER*, *supra* note 19, at 48-49.

33. The change in the amount in controversy, coupled with Indiana's recent abolition of prayers for specific dollar amounts in personal injury or wrongful death actions filed in Indiana state courts, IND. R. TR. P. 8(A)(2), could result in some interesting scenarios. Say, for instance, that the parties are diverse and the plaintiff, having suffered a broken leg and some lost wages in a car accident, seeks to recover approximately \$50,000 in damages. For tactical reasons the plaintiff's lawyer might want to be in state court where no specific money damages prayer would be made. The defense, however, might want to be in federal court, and would thus have to remove the action and take the awkward position that the claim is for more than \$50,000. Imagine, then, the eventual settlement conference where the defense offers \$25,000 claiming that the damages in no way reach the \$50,000 asked for by plaintiff. Such scenarios could be quite interesting, to say the least.

34. See IND. CODE § 34-1-2-8 (1988); *Huffman v. Hains*, 865 F.2d 920, 923-25

2. *Clarification of a Legal Representative's Citizenship.*—The Act amends section 1332(c) to clarify that a legal representative of the estate of a decedent, an infant, or an incompetent shall be deemed a citizen only of the same state as the individual or estate being represented.³⁵ The original rule was that the representative's citizenship counted for diversity purposes.³⁶ In the late 1960's, however, the courts began to take notice of the requirements of section 1359, which forbids jurisdiction over actions "in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court."³⁷ The representative's own citizenship is now irrelevant in the diversity context.

Some courts addressing the issue prior to the amendment held that a "motive/function" test should be used to address such situations, while others, including the Seventh Circuit, opted for the "substantial stake" test.³⁸ Still others, including the American Law Institute ("ALI"),³⁹ proposed a *per se* rule by which the decedent's domicile would determine citizenship for diversity purposes.⁴⁰

The amendment to section 1332(c) adopted by Congress follows the ALI proposal. The clarification will eliminate the need for the courts to wrestle further with these preliminary considerations and make it virtually impossible to manipulate diversity jurisdiction.⁴¹ On the other hand, the rule might exclude parties from federal court who have le-

(7th Cir. 1989); *Torres v. Parkview Foods*, 468 N.E.2d 580, 582-83 (Ind. Ct. App. 1984); *Huffman v. Anderson*, 118 F.R.D. 97, 100 (N.D. Ind. 1987).

35. The statute now reads as follows:

For the purposes of this section and section 1441 of this title . . . the legal representative of the estate of a decedent shall be deemed to be a citizen only of the same State as the decedent, and the legal representative of an infant or incompetent shall be deemed to be a citizen only of the same State as the infant or incompetent.

28 U.S.C. § 1332(c)(2) (1982).

36. See Siegel, *supra* note 12, at 409.

37. 28 U.S.C. § 1359 (1982). The Third Circuit first took note of the situation in *McSparran v. Weist*, 402 F.2d 867, 873 (3d Cir. 1968). There the court relied on the "assignment or otherwise" language to reject jurisdiction in a case in which an infant's representative was chosen solely to create diversity. *Id.* at 877 (emphasis added).

38. The split of authority is traced at length by the First Circuit in *Pallazola v. Rucker*, 797 F.2d 1116, 1121-26 (1st Cir. 1986).

39. See American Law Institute, *Study of the Division of Jurisdiction Between State and Federal Courts*, § 1301(b)(4), at 11 (1969), reprinted in Field, *Jurisdiction of Federal Courts: A Summary of American Law Institute Proposals*, 46 F.R.D. 141, 143 (1969).

40. The ALI's proposal found judicial support from Judge Murnaghan of the Fourth Circuit. See *Krier-Hawthorne v. Beam*, 728 F.2d 658, 670-71 (4th Cir. 1984) (Murnaghan, J., dissenting).

41. See *Pallazola*, 797 F.2d at 1125 (discussing the ALI proposal).

gitimate reasons for appointing an out-of-state representative.⁴² In any event, the amendment resolves an area of ambiguity. Like the amount in controversy increase, the amendment is effective for actions filed on or after May 18, 1989, and it has potential to exclude at least some actions that might have otherwise found their way to federal court based on diversity.

3. *The Removal Provisions are Simplified.*—The Act made several changes to removal procedures. The most significant change was an amendment placing an absolute limit on the time during which an action can be removed to federal court based on diversity jurisdiction. Specifically, section 1446(b) was amended to provide that "a case may not be removed on the basis of jurisdiction conferred by section 1332 of this title more than 1 year after commencement of the action." Prior to the amendment a defendant could attempt removal at any time during the pendency of a state action, so long as the removal papers were filed within thirty days of receipt of "a copy of an amended pleading, motion, order, or other paper from which it may first be ascertained that the case is one which is or has become removable. . . ."⁴³ Thus, the dismissal of a nondiverse party or similar circumstance occurring more than one year after commencement of an action, which formerly would have allowed removal, no longer opens the door to federal court.

This amendment does not contain an effective date and is thus presumptively applied from November 19, 1988, its enactment date.⁴⁴ It should also be noted that by the express language of the statute, the one year removal limitation applies only to diversity actions; claims may still be removed at any time within thirty days of any event, such as amendment of the complaint to add a federal claim, that would allow federal question jurisdiction.

Another change is that a bond is no longer required to be part of the removal papers.⁴⁵ In making this change, Congress amended section

42. *Id.* at 1126.

43. 28 U.S.C. § 1446(b) (1982).

44. See Siegel, *supra* note 12, at 403.

45. Congress did this by deleting former subsection (d) to section 1446, which required each petition for removal to be accompanied by a bond for costs and disbursements incurred by reason of the removal proceedings should it be determined that the case was not removable or was improperly removed. It is clear that bond is no longer required, despite the remaining inadvertent reference to "bond" in new section 1446(d) (old subsection (e)), which requires written notice of removal to the state court and adverse parties after the filing "of such petition for removal of a civil action and bond. . . ." 28 U.S.C. § 1446(d) (1982). The General Counsel for the Administrative Office of the United States Courts has written the Clerks of all the District Courts informing them that "it is clear that the removal bond requirement no longer exists." See Letter from William R. Burchill Jr., to Clerks of District Courts (Jan. 5, 1989) (discussing 1988 amendments to removal procedures) (on file at the Indiana Law Review office).

1447(c) to provide that if removal is determined to have been improper, the order remanding the case may require payment of just costs "and any actual expenses, including attorneys fees, incurred as a result of the removal." Congress injected the standards of Rule 11 into this equation by requiring that the initial "Notice of Removal" be signed "pursuant to Rule 11."⁴⁶ Thus, counsel considering removal must make the appropriate pre-filing investigation to avoid being hit with sanctions should the attempt to get into federal court fail.

4. *Venue of Actions Against Corporations is Modified.*—Finally, the Act also made important changes relating to the appropriate venue for actions against corporate defendants. Specifically, section 1391(c) of Title 28 was changed as follows:

OLD section 1391(c):

A corporation may be sued in any judicial district in which it is incorporated or licensed to do business or is doing business, and such judicial district shall be regarded as the residence of such corporation for venue purposes.

NEW section 1391(c):

For purposes of venue under this chapter, a defendant that is a corporation shall be deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced. In a State which has more than one judicial district and in which a defendant that is a corporation is subject to personal jurisdiction at the time an action is commenced, such corporation shall be deemed to reside in any district in that State within which its contacts would be sufficient to subject it to personal jurisdiction if that district were a separate State, and, if there is no such district, the corporation shall be deemed to reside in the district within which it has the most significant contacts.

This amendment, which appears on the surface to have little effect, actually works an expansion of corporate venue in some settings and a curtailment in others.⁴⁷

The expansion in available venues for actions against corporations will occur in those circuits in which the courts formerly interpreted the

46. 28 U.S.C. § 1446(a) (1982). This changes prior practice under which the filing was made by verified petition.

47. It should be noted that the test of subdivision (c) applies only when the plaintiff has chosen to lay venue in the defendant's district of residence under section 1391(a) or (b). Subdivision (c) does not preclude the plaintiff from laying venue in his own district of residence in a diversity case under section 1391(a) or in the district where the claim arose under section 1391(a) or (b). See 28 U.S.C.A. § 1391, Commentary on 1988 Revision (Supp. 1989).

"doing business" requirement of the old section 1391(c) more restrictively than the "doing business" test of long arm statutes for personal jurisdiction.⁴⁸ These courts reasoned that the standard for personal jurisdiction has its foundation in constitutional principles of fairness and federalism, whereas venue limitations stem from somewhat different Congressional notions of fairness.⁴⁹ In one reported decision from a district court of this circuit, Judge Nordberg found this view persuasive.⁵⁰

The recent amendment, however, follows the views of other courts and commentators that found the uniformity and simplicity of a consistent rule to be controlling.⁵¹ Under the new rule, if personal jurisdiction is appropriate against the corporation, then venue is proper as well. This is a common sense amendment that will avoid litigation over this technical issue in the future. Although the venue change removes a weapon from the pre-trial corporate arsenal, defendants have little to complain about as they remain protected by the personal jurisdiction limitations of the Constitution.

The amendment also works to contract available venue in those rare cases in which a corporation licensed to do business in a state used to be deemed, for venue purposes, to do business in the entire state.⁵² In a state such as Indiana having more than one district, a corporation based in, say, the Northern District could have been sued, for venue purposes, in the Southern District even if it had no contacts there. With the amendment adding the second sentence to section 1391(c), this will no longer occur.

B. A Change in Standards or the Death Knell for Pendent Party Jurisdiction?

During the survey period, the Supreme Court and the Seventh Circuit decided important cases relating to "pendent" and "pendent party" jurisdiction. These terms are commonly used to express the power of the federal courts to entertain state law claims based upon the existence of a related independent claim properly before the federal court. As is

48. See, e.g., *Maybelline Co. v. Noxell Corp.*, 813 F.2d 901, 903-05 (8th Cir. 1987); *Johnson Creative Arts, Inc. v. Wool Masters, Inc.*, 743 F.2d 947, 949 (1st Cir. 1984).

49. See, e.g., *Maybelline Co.*, 813 F.2d at 904-05.

50. See *Scotch Whisky Ass'n v. Majestic Distilling Co.*, 681 F. Supp. 1297, 1307 (N.D. Ill. 1988).

51. This view had been adopted by the Tenth Circuit in *Houston Fearless Corp. v. Teter*, 318 F.2d 822, 825 (1963), and by several well-respected commentators. See 1 J. MOORE, J. LUCAS, H. FINK, D. WECKSTEIN & J. WICKER, *MOORE'S FEDERAL PRACTICE* 1409-13 (2d ed. 1986); 15 WRIGHT & MILLER, *supra* note 19, at 123.

52. See Siegel, *supra* note 12, at 406-07.

discussed below, the Supreme Court seems to have altered the standard for invoking pendent party jurisdiction, and in doing so effectively abolished the concept altogether, leaving it to Congress to affirmatively demonstrate in its enactments that related state law claims may be maintained in federal court.

1. *The Seventh Circuit's Previous Standards for Pendent Party Jurisdiction.*—In January of 1989, the Seventh Circuit addressed the issues of pendent and pendent party jurisdiction in the case of *Huffman v. Hains*.⁵³ In that case a seller of stock had sued the buyer and an accountant alleging violations of federal securities laws. The seller added several state law claims including a malpractice action against the accountant. The state law claims against the accountant were based on the pendent jurisdiction concept set forth in the landmark case of *United Mine Workers v. Gibbs*,⁵⁴ wherein the Supreme Court held that federal courts have the discretionary power to hear related state law claims against federal defendants if the claims derive from a common nucleus of operative fact.⁵⁵

In *Huffman*, the federal claims against the accountant were dismissed after settlement. Thereafter, the district court dismissed the pendent claim and an appeal was taken. The Seventh Circuit affirmed the dismissal of the state claim on the usual grounds that the district court had not abused its discretion in relinquishing pendent jurisdiction.⁵⁶ What is interesting about the opinion, however, is its discussion of pendent *party* jurisdiction, a close cousin to *Gibbs* pendent jurisdiction that the Supreme Court arguably altered later in the survey period.

According to the Seventh Circuit, “[P]endent *party* jurisdiction arises when a plaintiff brings a federal claim in federal court against one party, and brings a related state-law claim against *another* party without an independent basis of federal jurisdiction.”⁵⁷ “Unlike pendent claim jurisdiction, there is still some debate over whether the federal courts have the power to exercise pendent *party* jurisdiction,”⁵⁸ and as a result the

53. 865 F.2d 920 (7th Cir. 1989).

54. 383 U.S. 715 (1966).

55. *Id.*

56. *Huffman*, 865 F.2d at 923. The discretionary relinquishment of pendent jurisdiction has been described by the Seventh Circuit as “almost unreviewable.” *Graf v. Elgin, Joliet & Eastern Ry. Co.*, 790 F.2d 1341, 1347 (7th Cir. 1986). Such a decision to “relinquish pendent jurisdiction before the federal claims have been tried is, as we have said, the norm, not the exception, and such a decision will be reversed only in extraordinary circumstances.” *Disher v. Information Resources*, 873 F.2d 136, 140 (7th Cir. 1989).

57. *Huffman*, 865 F.2d at 922 (emphasis in original).

58. *Id.*

doctrine has been called an "embattled" concept by the Seventh Circuit.⁵⁹ Nonetheless, as the court discussed in *Huffman*, the Seventh Circuit has allowed district courts to exercise pendent party jurisdiction in certain circumstances.⁶⁰

The "subtle and complex" question of pendent party jurisdiction has been analyzed in the Seventh Circuit by use of a two-step analysis:

First, the court must examine whether the constitutional power to exercise such jurisdiction exists. Second, the court must examine whether Congress has limited the court's power to exercise pendent party jurisdiction in the specific statutory provision conferring federal jurisdiction in that case. The constitutional power to exercise pendent party jurisdiction exists if the federal claim is not frivolous, the federal and state claims derive from a common nucleus of operative fact, and the federal and state claims are the kind that the plaintiff would ordinarily be expected to try . . . in one judicial proceeding. *The statutory power to exercise pendent-party jurisdiction depends upon whether Congress in the [particular statutory grant at issue] has . . . expressly or by implication negated pendent party jurisdiction.*⁶¹

The second step of this analysis, which the Seventh Circuit carefully traced in *Huffman* but did not apply due to affirmation on discretionary grounds, is based on the Supreme Court's 1976 decision in *Aldinger v. Howard*.⁶² In *Aldinger*, the Supreme Court, though rejecting the exercise of pendent party jurisdiction in that particular case under 28 U.S.C. section 1343(3) and 42 U.S.C. section 1983, wrote that "[o]ther statutory grants and other alignments of parties and claims might call for a different result."⁶³ The *Aldinger* Court explained its decision, writing:

Two observations suffice for the disposition of the type of case before us. If the new party sought to be joined is not otherwise subject to federal jurisdiction, there is a more serious obstacle to the exercise of pendent jurisdiction than if parties already before the court are required to litigate a state-law claim. Before it can be concluded that such jurisdiction exists, a federal court must satisfy itself not only that Art. III permits it [by using the common nucleus of operative facts test], *but that*

59. *Id.* (citing *Citizens Marine Natl. Bank v. United States Dept. of Commerce*, 854 F.2d 223, 226 (7th Cir. 1988)).

60. 865 F.2d at 922.

61. *Id.* at 922-23 (quotations and citations omitted) (emphasis added).

62. 427 U.S. 1 (1976).

63. *Id.* at 18.

*Congress in the statutes conferring jurisdiction has not expressly or by implication negated its existence.*⁶⁴

By these final words, the Supreme Court seemed to be laying down a standard for the federal courts to follow in determining, under a second prong of pendent party analysis, whether Congress has negated the possibility of such jurisdiction. Indeed, this was exactly the second standard described by the Seventh Circuit thirteen years later in *Huffman*.⁶⁵

2. *The Supreme Court's Most Recent Decision on Pendent Party Jurisdiction.*—This crucial aspect of pendent party analysis, however, has arguably been altered by a sharply divided Supreme Court decision during the survey period. Specifically, in *Finley v. United States*,⁶⁶ a five to four Court ruled that pendent party jurisdiction did not exist under the Tort Claims Act. On the surface, such a narrow decision involving the Tort Claims Act would seem to have little impact on federal jurisdiction as a whole. A close reading of the case, however, reveals that the Court has probably sounded the death knell for the “subtle and complex” concept of pendent party jurisdiction, or at least drastically altered its standards.

In *Finley*, a plane carrying Barbara Finley’s husband and two children struck electric power lines and crashed, leaving no survivors. Finley sued the Federal Aviation Administration in federal court under the Tort Claims Act,⁶⁷ and later moved to amend her complaint to include state law claims against non-diverse state defendants. The district court allowed the amendment on the basis of pendent party jurisdiction. On interlocutory appeal, however, the Ninth Circuit reversed and held that pendent party jurisdiction was not available under the Tort Claims Act, which provides federal court jurisdiction over civil actions against the United States for certain torts of federal employees. The Supreme Court granted certiorari to resolve a split in the circuits on the issue.⁶⁸

a. *The majority opinion.*—Affirming the Ninth Circuit and writing for the five member majority, Justice Scalia focused on the second prong of the pendent party test.⁶⁹ He did this by first specifically assuming, without deciding, that the constitutional criterion for pendent party

64. *Id.* (emphasis added).

65. In fact, the *Huffman* court specifically quoted the language from *Aldinger* underlined above. 865 F.2d at 923.

66. 109 S. Ct. 2003 (1989).

67. 28 U.S.C. § 1346(b) (1982).

68. 109 S. Ct. at 2005.

69. Justice Scalia was joined by Chief Justice Rehnquist, the author of *Aldinger*, and Justices White, O’Connor, and Kennedy. Justice Blackmun filed a short dissent, while Justice Stevens, joined by Justices Brennan and Marshall, authored a lengthy dissent that is highly critical of the majority. *Id.*

jurisdiction is analogous to the criterion for pendent claim jurisdiction; that is to say, that the “common nucleus of operative facts” line of analysis from *Gibbs* applies equally.⁷⁰ Justice Scalia then began his analysis of the legislative prong, writing, “Our cases show . . . that with respect to the addition of parties, as opposed to the addition of only claims, we will not assume that the full constitutional power has been congressionally authorized, and will not read jurisdictional statutes broadly.”⁷¹ He highlighted the Court’s decisions in *Zahn v. International Paper Co.*,⁷² *Owen Equipment & Erection Co. v. Kroger*,⁷³ and *Aldinger*,⁷⁴ in which the Court each time rejected the pendent party concept as applied to the particular statute in question.

The majority opinion then examined the “posture in which the federal claim is asserted,”⁷⁵ but dismissed as no consequence the “mere factual similarity” present between the state and federal claims.⁷⁶ The Court then acknowledged the difference between Mrs. Finley’s action and prior cases in that she could only bring the Federal Tort Claim in federal court due to exclusivity of jurisdiction.⁷⁷ The majority, however, held that such a factor alone is “not enough, since we have held that suits against the United States under the Tucker Act . . . brought only in federal court . . . cannot include private defendants.”⁷⁸

The *Finley* Court next looked to the text of the jurisdictional statute at issue. Because the Tort Claims Act confers jurisdiction over “civil actions on claims against the United States” rather than something like “civil actions on claims that include requested relief against the United States,” the majority concluded that “against the United States” means against the United States and no one else.⁷⁹ The Court then concluded on a policy note, writing that whatever they had said “regarding the

70. *Id.* at 2007. Justice Scalia later wrote that the majority had no intent to limit or impair the *Gibbs* line of cases, even though the majority labelled *Gibbs* “a departure from prior practice.” *Id.* at 2010.

71. *Id.* at 2007.

72. 414 U.S. 291, 301 (1973).

73. 437 U.S. 365, 372 (1978).

74. 427 U.S. 1 (1976).

75. *Finley*, 109 S. Ct. at 2007.

76. *Id.* at 2008.

77. Federal jurisdiction may be said to be exclusive when Congress has provided that an action may only be maintained in federal court, whereas concurrent jurisdiction means that the action is properly heard in federal or state court.

78. 109 S. Ct. at 2008 (citing *United States v. Sherwood*, 312 U.S. 584 (1941)).

79. *Id.* The Court then easily discounted plaintiff’s argument that a 1948 revision in the language of the FTCA changing “claim against the United States” to “civil actions on claims against the United States” somehow indicated a jurisdictional expansion. Rather, according to the Court, the revision simply followed the adoption of the use of the term “civil action” in the Federal Rules of Civil Procedure. *Id.* at 2009-10.

scope of jurisdiction conferred by a particular statute can of course be changed by Congress.”⁸⁰ “What is of paramount importance,” the majority wrote, “is that Congress be able to legislate against a background of clear interpretive rules, so that it may know the effect of the language it adopts.”⁸¹ The Court closed its opinion as follows: “All our cases - *Zahn*, *Aldinger*, and *Kroger* - have held that a grant of jurisdiction over claims involving particular parties does not itself confer jurisdiction over additional claims by or against different parties. Our decision today reaffirms that interpretive rule; the opposite would sow confusion.”⁸²

b. *The dissenting opinions.*—To the dissenters, however, the majority merely increased the confusion. Indeed, the prime complaint of both dissenting opinions is that the majority altered the standards for evaluating the legislative prong of the analysis without offering a clear substitute. Justice Blackmun, for instance, relying on the same language from *Aldinger* as the Seventh Circuit did in *Huffman*, explained his position as follows:

If *Aldinger v. Howard* required us to ask whether the Federal Tort Claims Act embraced an ‘affirmative grant of pendent party jurisdiction,’ [as the majority suggests], I would agree with the majority that no such specific grant of jurisdiction is present. But, in my view, that is not the appropriate question under *Aldinger*. I read the Court’s opinion in that case, rather, as requiring us to consider whether Congress has demonstrated an intent to *exempt* ‘the party as to whom jurisdiction pendent to the principal claim’ is asserted from being haled into federal court. And, as those of us in dissent in *Aldinger* observed, the *Aldinger* test would be rendered meaningless if the required intent could be found in the failure of the relevant jurisdictional statute to mention the type of party in question, ‘because all instances of asserted pendent-party jurisdiction will by definition involve a party as to whom Congress has impliedly “addressed itself” by not expressly conferring subject-matter jurisdiction on the federal courts.’⁸³

Justices Stevens, joined by Justices Marshall and Brennan, similarly complained that the *Finley* majority had adopted a “sharply different approach” without “even so much as acknowledging our statement in *Aldinger* that before a federal court may exercise pendent party juris-

80. *Id.* at 2010.

81. *Id.*

82. *Id.*

83. *Id.* at 2010-11 (Blackmun, J., dissenting) (quotations and citations omitted) (first emphasis added, second in original).

diction it must satisfy itself that Congress 'has not expressly or by implication *negated* its existence. . . .'"⁸⁴

c. *Analysis of the decision.*—There is at least room for disagreement with the majority's opinion. Without expressly adopting a new standard, the Court seems to have changed the focus of the legislative prong of the analysis from a search for *negative* legislative evidence tending to refute pendent party jurisdiction, as appeared to have been proposed in *Aldinger*, to a much more difficult search (for the party invoking such jurisdiction) for *affirmative* legislative evidence tending to show an actual intent by Congress to grant such power over pendent party claims. Such a shift in standards would be contrary to that followed by the Seventh Circuit, as shown in *Huffman*, as well as in other decisions and the dissenting opinions in *Finley*.⁸⁵

Moreover, the Court effectively removed the posture of the state claim as a factor in the analysis. It is difficult to imagine what type of posture might suffice for pendent party jurisdiction in light of the situation in *Finley* where the federal tort claim, unlike diversity or other claims involving concurrent jurisdiction and maintainable in a state or federal forum, could only be brought in federal court.

Thus, while the *Finley* decision may well be correct as a matter of policy and principle that pendent party jurisdiction should not be exercised in such a situation, it seems that the Court had to tip-toe around what seemed to have been the governing standard to reach its decision. If the Court really intended to change the standard, it is unfortunate that it did not expressly say so.

Yet the dissenting opinions provide enough authority for the lower courts to draw the conclusion that the standard was effectively changed. Indeed, there is already authority recognizing the shift.⁸⁶ Given that this is the case, one must seriously question whether pendent party jurisdiction survives today. It is this writer's opinion that the death knell has been rung, and that, as the majority suggests, only Congress can stop the reverberations.

84. *Id.* at 2020 (Stevens, J., dissenting) (emphasis added). Both dissenting opinions also attacked the majority's reliance on *Sherwood* (involving the Tucker Act and the Court of Claims) concerning the posture and context of the case. Justice Blackmun, for instance, wrote that *Sherwood* turned on the history of the Court of Claims' jurisdiction, which history Blackmun found no parallel for in tort claims against the United States in a tribunal without the power to litigate the liability of private tortfeasors. *Id.* at 2011 (Blackmun, J., dissenting).

85. *Id.* at 2015-18 (Stevens, J., dissenting).

86. See *Staffer v. Bouchard Transp. Co., Inc.*, 878 F.2d 638, 643 n.5 (2d Cir. 1989) (noting effect of *Finley*); TENTATIVE REPORT OF THE FEDERAL COURTS STUDY COMMITTEE, summarized in 58 U.S.L.W. 2442, 2445 (Feb. 6, 1990) (The Committee notes effect of *Finley* and suggests that Congress step in to overrule the decision by legislation).

III. SUMMARY JUDGMENT REVISITED: THE WARMING CONTINUES, WITH ONE EXCEPTION

As last year's federal practice Article discussed at some length, there has been a substantial warming towards summary judgment in the federal courts.⁸⁷ This change in attitude stems from the Supreme Court's trilogy of decisions in *Celotex Corp. v. Catrett*,⁸⁸ *Anderson v. Liberty Lobby, Inc.*,⁸⁹ and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*.⁹⁰ A review of this year's summary judgment decisions reveals that the courts of the Seventh Circuit continue to embrace the Supreme Court's mandate to dispose of factually unsupported claims when appropriate.

A. *The General Standards For the Non-movant*

As to the non-movant's burden of proof under *Celotex*, the Seventh Circuit authored several opinions reaffirming the rule that the non-movant cannot stand by quietly when a proper summary judgment motion has been filed. The general standard was succinctly stated by Judge Manion in *Zayre Corp. v. S.M. & R. Co.*,⁹¹ when he wrote:

Summary judgment is appropriate where no genuine issue of material facts exist and the moving party is entitled to judgment as a matter of law. The moving party bears the initial burden of showing that no genuine issue of material fact exists. Once the moving party has demonstrated the absence of any genuine factual issues, the nonmoving party may not merely rest upon the allegations or denials in its pleadings but must present specific facts showing that a genuine issue exists for trial.⁹²

Similar but much stronger language is found in *Herman v. City of Chicago*,⁹³ where the court, in affirming summary judgment in a civil rights action, wrote that a "district court need not scour the record to make the case of a party who does nothing."⁹⁴ The Seventh Circuit bluntly remarked that "courts will not discover that the movant slighted contrary information if opposing lawyers sit on their haunches; judges may let the adversary system take its course."⁹⁵ The lesson from such

87. See Maley, *1988 Developments*, *supra* note 1.

88. 477 U.S. 317 (1986).

89. 477 U.S. 242 (1986).

90. 475 U.S. 574 (1986).

91. 882 F.2d 1145, 1148 (7th Cir. 1989).

92. *Id.*

93. 870 F.2d 400 (7th Cir. 1989).

94. *Id.* at 404.

95. *Id.*

cases is clear: anticipate summary judgment motions and do not treat them lightly.

B. Summary Judgment In Motive or Intent Cases

In a number of cases the Seventh Circuit held that summary judgment was proper, notwithstanding the fact that the litigation turned on issues of motive or intent. For instance, in *Corrugated Paper Products, Inc. v. Longview Fibre Co.*,⁹⁶ the court affirmed Judge Miller's entry of summary judgment in a third party beneficiary contract case that turned on the intent of the contracting parties when executing the contract. Under the governing state law, the court had to determine whether the two contracting parties intended to confer a benefit upon the purported third party beneficiary.⁹⁷

The Seventh Circuit explained that the purported beneficiary had come forward with no evidence that both contracting parties intended to confer such a benefit. In fact, the court explained, the defendant offered deposition testimony from three employees that consistently refuted the claim of intent to benefit the plaintiff. "If credited," the court wrote, "this testimony alone would seem to dispose of [plaintiff's] contention that it is a third-party beneficiary. . . ."⁹⁸ "However," the Seventh Circuit cautioned, "this evidence relates to [defendants'] state of mind, was solely in [their] control . . . and might have been disbelieved by a jury in its evaluation of credibility." Because of this, the court noted that it was "not immediately clear whether this evidence in itself may serve as a basis for summary judgment."⁹⁹

The *Corrugated Paper* court, however, then answered this question in the affirmative. While noting that a court "must be circumspect in granting summary judgment based solely on the defendant's categorical denial that the requisite mental state existed," the Seventh Circuit concluded that where the plaintiff has had the opportunity to depose the defendant to test his veracity, but has failed to "'shake' the defendant's version of the facts or to raise issues of credibility, summary judgment for the defendant may ordinarily be granted."¹⁰⁰ This is so unless the plaintiff has come forth with other significant probative evidence on the mental state at issue.

The following passage from the *Corrugated Paper* opinion sums up the current status of summary judgment in "state of mind" cases in the Seventh Circuit:

96. 868 F.2d 908 (7th Cir. 1989).

97. *Id.* at 912.

98. *Id.* at 913.

99. *Id.* at 913-14.

100. *Id.* at 914.

It is well-settled that summary judgment may be granted where the controlling issue is whether or not the movant acted with a particular mental state. Although the movant's testimony about the existence of a particular mental state may not be dispositive, the movant is entitled to summary judgment if the burden is on the nonmovant to establish the state of mind and the nonmovant has failed to come forward with even circumstantial evidence from which a jury could reasonably infer the relevant state of mind.

* * *

Where, as here, the movant's witnesses have been examined by the nonmovant in depositions, the nonmovant ordinarily must identify specific factual inconsistencies in the witness' testimony in order to withstand a motion for summary judgment. The opposing party may not merely recite the incantation, "Credibility," and have a trial on the hope that a jury may disbelieve factually uncontested proof.¹⁰¹

The importance of this and other recent Seventh Circuit cases dealing with summary judgment and motive or intent issues¹⁰² cannot be overlooked. Many of the cases heard by the federal courts involve state of mind issues, and counsel on each side will want to formulate their strategy early in the litigation to either obtain or defend summary judgment accordingly.

1. *The Quality of Proof - Beware of the Requirements of Rule 56(e).*—Rule 56(e) of the Federal Rules of Civil Procedure speaks to the quality of evidence that must be used in supporting and defending motions for summary judgment. It reads:

Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in

101. *Id.* (footnote and quotations omitted). Cf., *Persinger v. Marathon Petroleum Co.*, 699 F. Supp. 1353, 1363 (S.D. Ind. 1988) (district court, in granting summary judgment, rejects conclusory argument that one of the non-movant's affidavits was "open to serious question." The court wrote that a "motion for summary judgment *cannot* be defeated merely by an opposing party's incantation of lack of credibility over a movant's supporting affidavit.")) (emphasis in original).

102. See *McMillan v. Svetanoff*, 878 F.2d 186, 188 (7th Cir. 1989) (affirming summary judgment in an action brought under 42 U.S.C. sections 1981 and 1983, noting that "while we approach the question of summary judgment with 'special caution' in discrimination cases, we will not hesitate to affirm the grant of summary judgment where the plaintiff presents no indication of the defendant's motive or intent to support his or her position."); *Morgan v. Harris Trust & Savings Bank of Chicago*, 867 F.2d 1023, 1026 (7th Cir. 1989) (affirming summary judgment in Title VII action, court writes that summary judgment "will not be defeated simply because issues of motive or intent are involved.").

evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the[ir] mere allegations or denials . . . but the adverse party's response, by affidavits or [otherwise] must set forth specific facts showing that there is a genuine issue for trial.¹⁰³

Several decisions from the survey period illustrate the care that must be taken to follow Rule 56(e) in submitting proof to support and defend motions for summary judgment.

Perhaps the best example is *Mid-State Fertilizer v. Exchange National Bank*,¹⁰⁴ a banking case in which the Seventh Circuit, through Judge Easterbrook, affirmed summary judgment in favor of the lender. Because of the significance of the opinion to summary judgment practitioners, a thorough discussion of the case is warranted.

The plaintiff-borrower, Mid-State Fertilizer company, sold fertilizer in Illinois. In order to meet its daily outflows until it could collect from customers, it sought and obtained revolving credit from the Exchange Bank. The bank promised to lend Mid-State 70% of its inventory and receivables, while Mid-State agreed to direct its customers to make all payments to a lock box the bank would control. The bank would retrieve the checks and deposit them into a "blocked account" from which it alone could withdraw the cash. The bank would then apply the payments to the loan and apply the surplus to Mid-State's own savings account. This arrangement was a variant of factoring which banks call "asset based financing."¹⁰⁵

All was well until Mid-State Fertilizer began to fall into hard times. The bank first limited the amount it would extend as credit, and later discovered that some of Mid-State's customers had bypassed the lock box and made payment of one million dollars directly to Mid-State. Mid-State defaulted on its loans, could not find other financing, and went into liquidation under Chapter 7 of the Bankruptcy Code.¹⁰⁶

The federal litigation began, not by the bank suing the borrower for fraud, breach of contract, or the like, but by the defaulted borrower filing an action against the bank for state law contract claims, as well

103. FED. R. Crv. P. 56(e).

104. 877 F.2d 1333 (7th Cir. 1989).

105. *Id.* at 1333-34.

106. *Id.* at 1334.

as federal RICO¹⁰⁷ and Bank Holding Company Act¹⁰⁸ claims. The district court granted summary judgment on the federal claims and exercised its discretion to dismiss the pendent state law claims. The Seventh Circuit affirmed as to all claims,¹⁰⁹ but its discussion of summary judgment proof for the Bank Holding Act claim is what makes *Mid-State Fertilizer* a noteworthy opinion for federal practitioners in all types of civil litigation.

Mid-State's Bank Holding claim was based on the bank anti-tying statutes that forbid linking the extension of credit to other bank services. One such section prohibits a bank from extending credit on the condition that the borrower refrain from obtaining credit or services at another bank.¹¹⁰ The statute, however, expressly allows the bank to impose such a condition on the borrower's credit if it is "reasonably impose[d] . . . to assure the soundness of the credit."¹¹¹ Mid-State argued that the bank violated this anti-tying statute by requiring the lock box and blocked account arrangement. Based on affidavits of the bank that such arrangements are common and necessary when dealing with small businesses in the volatile agricultural industry, the district court granted summary judgment for the bank on the anti-tying claims.¹¹²

In affirming summary judgment on this issue, Judge Easterbrook began by noting that the statutory words that the bank could "reasonably impose" certain conditions sound like a factual question that would ordinarily preclude summary judgment.¹¹³ Indeed, Mid-State, in response to the bank's summary judgment affidavits stating that these lockbox arrangements are common and necessary in such credit arrangements, thought that it had preserved the factual issue by submitting an affidavit from a respected scholar and a former director of the Exchange Bank itself.¹¹⁴ The Seventh Circuit, however, agreed with the district court that the affidavit was deficient under Rule 56(e) because it did not recite "any of the specific facts or steps in his reasoning."¹¹⁵

This is an important holding, for on its surface the affidavit, given by an apparently reputable and qualified expert in the field, seemed to put the key factual points at issue. The affiant had recited that, in his

107. 18 U.S.C. §§ 1962(a), 1964(c) (1988).

108. 12 U.S.C. §§ 1972, 1975 (1988).

109. *Mid-State*, 877 F.2d 1333.

110. 12 U.S.C. § 1972(1)(E) (1988).

111. *Id.*

112. 877 F.2d at 1338.

113. *Id.* at 1337.

114. *Id.* at 1337-38.

115. *Id.* at 1339 (quoting *Mid-State Fertilizer Co. v. Exchange Nat'l Bank*, 693 F. Supp. 666, 670 (N.D. Ill. 1988)).

opinion, the loan arrangement including the lock box was not necessary to assure repayment, was not necessary to assure the soundness of the credit, and was not an appropriate traditional banking practice.¹¹⁶ Finally, the expert wrote that his opinions were based on his education, training, experience, as well as his review of pleadings and documents in the case.¹¹⁷

On close examination, however, the Seventh Circuit ruled that the affidavit did not comply with the Rule 56(e) requirement that affidavits shall ““set forth facts.””¹¹⁸ In the case of experts, the *Mid-State* court wrote that this requires a “process of reasoning beginning from a firm foundation,” and not just a final opinion.¹¹⁹ The court expounded on the issue, writing, “Professor Bryan [the affiant] would not accept from his students or those who submit papers to his journal an essay containing neither facts nor reasons; why should a court rely on the sort of exposition the scholar would not tolerate in his professional life?”¹²⁰

Moreover, the Seventh Circuit wrote, the court should not rely on such an affidavit “when the declaration makes no sense.”¹²¹ According to Judge Easterbrook, Professor Bryan’s assertion that a lock box is inappropriate in essence “accuses the bank of irrational conduct - not a common assumption for an economist.”¹²² “Anyway,” the court wrote, “how can payments from customers direct to the bank not be ‘traditional’ when that is the cornerstone of factoring and asset-based lending?”¹²³

Relying on the *Matsushita* branch of the Supreme Court’s trilogy of summary judgment decisions, Judge Easterbrook further noted that “if the factual context renders [the] claim implausible—if the claim is one that simply makes no economic sense—[the plaintiffs] must come forth with more persuasive evidence to support their claim than would otherwise be necessary.”¹²⁴ Easterbrook concluded that the affiant “might have been able to demonstrate that his conclusions rest[ed] on a sound foundation even though they appear[ed] fantastic, but he did not try.”¹²⁵

In concluding his opinion, Judge Easterbrook explained why he had gone to such lengths to attack the affidavit, writing, “We have gone into detail not because essential to sustain [the district court’s] decision

116. *Id.* at 1338-39.

117. *Id.* at 1339.

118. *Id.*

119. *Id.*

120. *Id.* at 1339.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.* (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. at 587).

125. *Id.* at 1340.

but because ukase¹²⁶ in the guise of expertise is a plague in contemporary litigation.”¹²⁷ In this case,

[the affiant] offered the court his CV rather than his economic skills. Judges should not be buffaloed by unreasoned expert opinions. . . . ‘The importance of safeguarding the integrity of the [judicial] process requires the trial [or appellate] judge, when he believes that an expert’s testimony has fallen below professional standards, to say so, as many judges have done.’ [The affiant] cast aside his scholar’s mantle and became a shill for Mid-State; [the district court], by observing that the emperor has no clothes, protected the interests of the judicial system.¹²⁸

While Judge Ripple separately concurred to express his opinion that “all that needs to be said with respect to the role of the affidavit” was to reiterate the district court’s conclusion that the affidavit failed for want of specific facts,¹²⁹ the *Mid-State* case shows that the Seventh Circuit is not hesitant to follow the teachings of *Matsushita* that the courts may look into the factual context of the proffered evidence to determine whether such evidence should even be considered. Just as importantly, the majority and concurring opinions teach that the “specific facts” requirements of Rule 56(e) must be followed in summary judgment. Judge Easterbrook went well out of his way to profess his opinions on these issues, and local federal practitioners would be well advised to heed his teachings, regardless of whether one agrees with them on a policy level.

Also instructive is *Randle v. LaSalle Telecommunications, Inc.*,¹³⁰ in which the Seventh Circuit affirmed summary judgment in a section 1981 claim and explained that certain evidence proffered by the plaintiffs could not be considered under Rule 56(e) because it was hearsay. Rule 56(e), it should be recalled, states that summary judgment affidavits “shall set forth such facts as would be admissible in evidence.”¹³¹ This admissibility requirement, which has been given a flexible interpretation in many instances,¹³² was strictly construed to exclude hearsay deposition testimony in *LaSalle Telecommunications*.¹³³

126. “Ukase” is defined as a Russian edict or order emanating from the government and having the force of law. *New Webster Dictionary of the English Language* 906 (1971).

127. 877 F.2d at 1340.

128. *Id.* (quoting *Deltak, Inc. v. Advanced Systems, Inc.*, 574, F. Supp. 400, 406 (N.D. Ill. 1983), vacated on other grounds, 767 F.2d 357 (7th Cir. 1985)) (citations omitted).

129. *Id.* at 1341 (Ripple, J., concurring).

130. 876 F.2d 563 (7th Cir. 1989).

131. FED. R. Crv. P. 56(e) (emphasis added).

132. See, e.g., *Reed v. Ford Motor Co.*, 679 F. Supp. 873, 874 (S.D. Ind. 1988)

In one of the proffered depositions, the plaintiff testified that a LaSalle employee had told her that one of LaSalle's executives had once stated: "[I]f he had his way he wouldn't deal with any of them [women or blacks]. . .[sic]"¹³⁴ In another affidavit a witness testified that the same executive and other LaSalle personnel had "reached a consensus that steps would be taken" to discriminate against the plaintiff's company.¹³⁵

The Seventh Circuit, however, rejected such evidence as hearsay, writing, "Rule 56(e) requires that supporting evidentiary affidavits "shall set forth facts as would be admissible in evidence." Based on this requirement, our cases have stressed that we are unable to consider hearsay statements that are not otherwise admissible at trial. The same limitation applies to deposition testimony based on inadmissible hearsay."¹³⁶ Thus, the *LaSalle Communications* opinion teaches that lawyers must proffer non-hearsay testimony at the summary judgment stage. If counsel has no choice but to rely on arguable hearsay, it would be wise to be prepared to demonstrate that such evidence will be admissible at trial under an appropriate hearsay exception. If it is simply a matter of locating the appropriate witness to relay the evidence and counsel needs more time, the remedy is found in Rule 56(f), which allows the court to grant a continuance to permit affidavits to be obtained or depositions to be taken, "or discovery to be had or. . . make such other order as is just."¹³⁷

2. *The Truth or the Consequences.*—The final summary judgment opinion to be discussed gives the plaintiff's bar some reason for cheer in the midst of the summary judgment trend that typically favors defendants. In *Goka v. Bobbitt*,¹³⁸ the Seventh Circuit reversed summary judgment in a prisoner's civil rights action against two prison officials. This, in and of itself, is not particularly noteworthy. What is deserving of comment, however, is the fact that the Seventh Circuit ordered the district court to consider on remand whether sanctions should be imposed

(noting that Rule 56(e) "does not require an unequivocal conclusion that the evidence will be admissible at trial as a condition precedent to its consideration on a summary judgment motion.").

133. 876 F.2d at 563.

134. *Id.* at 570 n.4.

135. *Id.*

136. *Id.* (citations omitted).

137. FED. R. Crv. P. 56(f). Note, however, that the failsafe device of Rule 56(f) must be promptly invoked before the trial court if it appears that additional time will be needed. As the Seventh Circuit made clear in *Goldberg v. Household Bank*, 890 F.2d 965, 968 (7th Cir. 1989), "an appellate brief is the wrong place to raise, for the first time, an argument that things moved too expeditiously in the district court."

138. 862 F.2d 646 (7th Cir. 1988).

against defense counsel who had successfully obtained summary judgment below.¹³⁹

In *Goka*, the defense counsel moved for and obtained summary judgment despite her presumed knowledge of a genuine issue of material fact.¹⁴⁰ Counsel's knowledge was shown by conflicts in the parties' depositions on a key factual issue.¹⁴¹ Defense counsel nonetheless argued that under *Celotex* her duty was to identify only those portions of the record that supported the defendants' position, even though "there exist[ed] evidence to the contrary of which defendants [were] aware."¹⁴² The Seventh Circuit made clear, however, that such an argument is untenable given Rule 56's purpose "to isolate and dispose of *factually unsupported* claims or defenses."¹⁴³

Moreover, the court held that such conduct implicates consideration of sanctions. The court wrote:

When a party has obtained knowledge through the course of discovery, or otherwise, that a material factual dispute exists and yet proceeds to file a summary judgment motion, in hopes that the opposing party will fail or be unable to meet its burden in responding to the motion, he defeats that purpose; and, more importantly, violates the rules of procedure which govern the conduct of trial, specifically Rule 11.¹⁴⁴

The *Goka* decision teaches the obvious, and it is unfortunate that it took appellate court review to rectify the situation in that particular case. Nonetheless, the case serves as a good reminder that litigation is more than just a game in which the player with the best tactics prevails. Rather, lawyers at all times must shoulder and respect the ethical responsibilities that go with being an officer of the court. If that means telling a client that summary judgment is impossible given the record, then so be it.

Counsel considering summary judgment should not be overly worried about *Goka* and its implications if a proper pre-filing review of the record and applicable law is undertaken. On the other hand, those who ignore the mandate of Rule 11 and choose not to conduct such a review do so at considerable risk and detriment not only to themselves, but,

139. *Id.* at 652.

140. *Id.* at 651.

141. *Id.* at 650-51.

142. *Id.* at 650.

143. *Id.* at 650 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24) (emphasis supplied by Seventh Circuit).

144. *Id.*

as *Goka* illustrates, also to their client, the opponent, and the system of justice we are duty-bound to uphold.

IV. THE POWER OF THE FEDERAL COURTS TO CONTROL THE LITIGATION BEFORE THEM

Two Seventh Circuit decisions from the survey period illustrate the power of the federal courts to control the parties and counsel that come before them. This Article will only briefly highlight the decisions so that practitioners are aware of them. The basic principles from the cases could be relevant in any number of imaginable scenarios.

First, in *G. Heileman Brewing Co. v. Joseph Oat Corp.*,¹⁴⁵ a sharply divided Seventh Circuit, sitting *en banc*, held that district courts are entitled to order *parties* who are represented by counsel to appear before them in person at pre-trial conferences for the purposes of discussing the posture and settlement of a case. The six to five decision produced five separate dissents and thus resembled the final result in many Supreme Court cases.¹⁴⁶

The central issue was whether “the authority to order parties as well as attorneys, to appear” resides in the courts notwithstanding the language of Rule 16(a)(5) of the Federal Rules of Civil Procedure, which provides that “the court may . . . direct the attorneys for the parties . . . to appear before it for a conference . . . for such purposes as . . . facilitating the settlement of the case.” The corporate defendant that was sanctioned for failing to send a corporate representative to a pre-trial conference argued that Rule 16 prevents a district court from requiring more than the party’s attorney to be present.

A majority of the Seventh Circuit rejected this argument, however, holding instead that the courts have significant procedural authority outside the explicit language of the Federal Rules. The court reasoned that “[t]he wording of the rule and the accompanying commentary make plain that the entire thrust of the amendment to Rule 16 was to urge judges to make wider use of their powers and to manage actively their dockets from an early stage.”¹⁴⁷ The majority then concluded that the district court had not abused its discretion in ordering such attendance, and that the imposition of sanctions was appropriate for the defendant’s failure to produce such a representative.¹⁴⁸

145. 871 F.2d 648 (7th Cir. 1989) (*en banc*).

146. Judge Kanne authored the majority opinion, and was joined by Chief Judge Bauer and Judges Cummings, Wood, Cudahy, and Flaum. Judges Posner, Coffey, Easterbrook, Ripple, and Manion all filed separate dissenting opinions in which all but Judge Posner were joined by some of their colleagues.

147. 871 F.2d at 652.

148. *Id.* at 656-57.

The dissenting opinions launched a variety of objections to the majority's holding. Perhaps the most interesting, for purposes of this Article, is Judge Posner's comment that "it is the rare attorney who will invite a district judge's displeasure by defying a request to produce the client for a pretrial conference."¹⁴⁹ This is especially true today now that a majority of the court has given the district courts broad powers to require such attendance.

A critical analysis of the decision is beyond the scope of this Article, and such reviews will no doubt be given by numerous commentators.¹⁵⁰ What is important is that practitioners ensure that their clients comply with such orders, and that counsel can now consider seeking such an order in appropriate cases. As many of the opinions in *Heileman Brewing* discuss, the district courts can effectively use such devices to promote settlement. Whether this is appropriate on a policy level is relevant in the Seventh Circuit only to the extent that it impacts the district court's discretionary decision whether to require such attendance or not. The power to do so is now firmly established in this circuit; as a result there will probably be more use of such an order.

A second case illustrating the power of the courts involves the tools available to slow repetitive filings of a "frequent filer." In the case of *In Re Davis*,¹⁵¹ the Seventh Circuit approved of a district court's injunction requiring a frequent litigant to submit proposed filings to an executive committee of the judges for screening. The Seventh Circuit held that such a procedure does not impermissibly bar the courthouse door to the plaintiff. Rather, the court reasoned, such a procedure is consistent with the courts' "inherent power and constitutional obligation to protect their jurisdiction from conduct which impairs their ability to carry out Article III functions."¹⁵²

The *Davis* case thus further illustrates the power of the federal courts to control the litigation before them. Practitioners opposing such a frequent filer may be able to seek reprieve pursuant to that clear power.

V. RULE 609(A) REQUIRES THE FEDERAL COURTS TO ALLOW IMPEACHMENT OF A CIVIL WITNESS WITH PRIOR CONVICTIONS: WHAT EFFECT ON FEDERAL CIVIL PRACTICE?

Rule 609 addresses the question of how, when, and what types of criminal convictions can be used to impeach a witness in federal court. Its somewhat awkward language reads as follows:

149. *Id.* at 657 (Posner, J., dissenting).

150. See, e.g., Reidinger, *Then It's Settled - 7th Circuit Upholds Rule 16 Order*, 75 A.B.A. J. 92 (July 1989) (showing significance of case).

151. 878 F.2d 211 (7th Cir. 1989).

152. *Id.* at 212 (quoting *In re McDonald*, 109 S. Ct. 993, 996 n.8 (1989)).

(a) For the purpose of attacking the credibility of a witness, evidence that the witness has been convicted of a crime shall be admitted if elicited from the witness or established by public record during cross-examination but only if the crime (1) was punishable by death or imprisonment in excess of one year under the law under which the witness was convicted, and the court determines that the probative value of admitting this evidence outweighs its prejudicial effect to the *defendant*, or (2) involved dishonesty or false statement, regardless of the punishment.

(b) Evidence of a conviction under this rule is not admissible if a period of more than ten years has elapsed . . . unless the court determines, in the interests of justice, that the probative value of the conviction supported by specific facts and circumstances substantially outweighs its prejudicial effect . . .¹⁵³

In the civil context, this Rule has caused problems in interpretation because the Rule's use of the word "'defendant'" creates inescapable ambiguity."¹⁵⁴ The central question that has divided courts and commentators is whether Rule 609(a) requires prior convictions to be admitted in civil cases without any discretionary balancing by the district judge.

Because of a split in the circuits on this point,¹⁵⁵ the Supreme Court recently took up the issue and resolved the matter for good, or at least until such time that Congress approves of a proposed amendment to the rule. In *Green v. Bock Laundry Machine Co.*,¹⁵⁶ the Court, by a six to three vote, squarely held that the felony balancing test of Rule 609(a) for the "defendant" applies only in criminal actions.¹⁵⁷ Moreover, the Court ruled that the discretionary balancing standard of Rule 403 is inapplicable to convictions in civil actions because of Rule 609's mandatory "shall be admitted" language.¹⁵⁸

Thus, after *Bock Laundry*, the federal district courts hearing civil actions have *no* discretion to prohibit impeachment with felonies or crimes of dishonesty or false statement that are less than ten years old. The only discretion the judge retains in civil cases is for crimes more

153. FED. R. EVID. 609(a), (b) (emphasis added).

154. *Green v. Bock Laundry Machine, Co.*, 109 S. Ct. 1981, 1995 (1989) (Blackmun, J., dissenting).

155. See *Brown v. Flury*, 848 F.2d 158 (11th Cir. 1988) (discussing split in the circuits).

156. 109 S. Ct. 1981 (1989).

157. 109 S. Ct. at 1993.

158. Rule 403 provides: "Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence." FED. R. EVID. 403.

than ten years old under Rule 609(b). This is obviously an important case for trial lawyers. It confirms the wisdom of two recent opinions from the Seventh Circuit,¹⁵⁹ and in so doing strips trial judges of their discretion in this controversial area.

The holding is also important to local practitioners in the early preparation of their cases. One subject that should be considered prior to filing any action is whether a party's witnesses will be subject to mandatory impeachment under *Bock Laundry*. If any civil witness has a felony conviction or a conviction for a crime of dishonesty or false statement, and if such conviction is less than ten years old, counsel must know this and plan accordingly. Competent opposing counsel will certainly learn this through discovery and might be able cloud the real issues at trial by impeaching the witness.

One factor to be evaluated is whether the *Bock Laundry* holding makes the federal forum less desirable in those cases in which counsel has a choice between state or federal court. In order to make this determination, counsel must be aware of the Indiana (or other applicable state) rule on impeachment by prior conviction. In Indiana, for instance, the case law "emphasizes the nature of the offense and its tendency to reflect upon veracity, [and thus] differs from the federal rule, which emphasizes seriousness of the offense and remoteness."¹⁶⁰ The Indiana rule, which was established in 1972 in the case of *Ashton v. Anderson*,¹⁶¹ is that prior convictions are admissible for impeachment purposes if (1) the crime involved dishonesty or false statement, or (2) the conviction was for an "infamous" crime such as murder, rape, arson, burglary, robbery, kidnapping, forgery, and wilful and corrupt perjury.¹⁶² Just as in federal courts, the trial judge has no discretion in admitting these particular crimes.¹⁶³

159. See *Campbell v. Greer*, 831 F.2d 700 (7th Cir. 1987) (two judges holding that trial court has no discretion in civil actions on this issue, with one judge separately concurring to argue that the issue did not need to be reached in that particular case); *Hernandez v. Depeda*, 860 F.2d 260 (7th Cir. 1988) (following *Campbell*).

160. 12 R. MILLER, INDIANA PRACTICE - INDIANA EVIDENCE § 609.111, at 578 (1984) [hereinafter MILLER, INDIANA EVIDENCE].

161. 258 Ind. 51, 279 N.E.2d 210 (1972).

162. See MILLER, INDIANA EVIDENCE, *supra* note 160, at 568-69. The Indiana Court of Appeals determined in 1989 that an attempt to perform any of the infamous crimes is also admissible under *Ashton*. See *Adams v. State*, 542 N.E.2d 1362, 1366-67 (Ind. Ct. App. 1989). The *Adams* court reasoned that the heinousness of an infamous crime such as rape "is not lessened merely because the rapist was prevented from completed the rape." *Id.*

163. *Ashton*, 258 Ind. at 61, 279 N.E.2d at 216 (stating there is "little wisdom in permitting the exclusion of such evidence to rest in the sound discretion of the trial court.").

Thus, the bar is left with the following summary of the status of impeachment by prior convictions in Indiana and federal forums:

1. *Type of crime:*

In Indiana, only the eight infamous crimes and crimes of false statement or dishonesty are used for impeachment.

In federal court, *any* crime punishable by imprisonment in excess of one year, as well as any crime of false statement or dishonesty can be used for impeachment.

2. *Remoteness of the crime:*

In Indiana, it is irrelevant whether the crime is more than ten years old. The trial court *must* admit it if it is covered by *Ashton*.¹⁶⁴

In federal court, the trial court must admit the 609(a) crime if it is less than ten years old. If the crime is more than ten years old, the court has discretion.

The net effect of this is that after *Bock Laundry*, there are certain crimes that must be admitted in federal court that would not be usable in state court. For instance, a drug-related offense that carries more than a one year imprisonment *must* be admitted in federal court if that crime occurred less than ten years ago. In Indiana, however, such a crime is *not* admissible because it is not an infamous crime nor a crime of dishonesty or false statement under *Ashton*.¹⁶⁵

The Indiana courts have held that a number of offenses do not qualify as dishonesty or false statement crimes under *Ashton*. These include assault, malicious trespass, prostitution, escape, possession of a gun without a permit, failure to pay child support, and assisting a criminal.¹⁶⁶ However, to the extent that any of these crimes are punishable by imprisonment of more than one year,¹⁶⁷ they would be admissible in federal court. Thus, a witness having such a conviction would not be impeached in Indiana, but would be in federal court.

If, on the other hand, the witness has a conviction that is more than ten years old, the federal forum may be more desirable if it appears that a good argument can be made that the probative value of the

164. See *Cox v. State*, 419 N.E.2d 1279, 1283 (Ind. 1981) (requirement of FED. R. EVID. 609 that crime be less than ten years old does not apply in Indiana state courts).

165. See *Johnston v. State*, 517 N.E.2d 397, 401 (Ind. 1988) ("Obviously drug offenses are not included in this list of impeachable offenses.").

166. See MILLER, INDIANA EVIDENCE, *supra* note 160, § 609.103, at 118 (Supp. 1989) (collecting cases).

167. Counsel faced with a witness having such a conviction should check the appropriate statute to determine the length of punishment and hence its admissibility in federal court.

conviction is outweighed by its prejudicial effect under Rule 609(b). Remoteness of conviction is not a factor in Indiana state courts, so counsel should consider the federal forum if such a scenario is presented.

Thus, the *Bock Laundry* rule will be felt at all stages of litigation. In cases that could turn on the credibility of a witness with a prior conviction and where concurrent federal and state jurisdiction exists over the claim, the desirability of the state or the federal forum should be considered.

As this Article went to print, the Supreme Court had just issued a proposed amendment to Rule 609(a) that would, in essence, negate the effect of its *Bock Laundry* decision. On January 26, 1990, the Court sent its proposed amendment to Congress for consideration. The proposed rule would read as follows:

Rule 609. Impeachment by Evidence of Conviction of Crime

(a) General Rule.—for the purpose of attacking the credibility of a witness,

- (1) evidence that a witness *other than an accused* has been convicted of a crime shall be admitted, *subject to Rule 403*, if the crime was punishable by death or imprisonment in excess of one year under the law under which the witness was convicted, and evidence that an accused has been convicted of such a crime shall be admitted if the court determines that the probative value of admitting this evidence outweighs its prejudicial effect to the accused; and
- (2) evidence that any witness has been convicted of a crime shall be admitted if it involved dishonesty or false statement, regardless of the punishment.¹⁶⁸

Pursuant to 28 U.S.C. § 2074, this amendment becomes law on December 1, 1990, if Congress does not affirmatively take action to reject the amendment.¹⁶⁹

Thus, effective December 1, 1990, Rule 609(a) will change to allow district courts to use the balancing test of Rule 403 in admitting non-false statement felonies in civil actions, unless, of course, Congress rejects the amendment. Congress should and probably will adopt the changes; it must take affirmative action to do otherwise, which is easier said than done.

168. See Communication from the Chief Justice Of The United States Transmitting An Amendment To The Federal Rules of Evidence (Jan. 26, 1990) (emphasis added) [hereinafter “Proposed Amendment to Rule 609”].

169. See 28 U.S.C.A. § 2074 (West Supp. 1989); Commentary on 1988 Revision to 28 U.S.C.A. § 2074 (West Supp. 1989) (discussing Rule-making procedures).

Even if the changes are implemented, however, counsel should still pay special attention to Rule 609. There will still be differences in the type of crimes available for impeachment in federal and state courts, and the remoteness of the crime will remain a consideration only in federal court. Counsel should still consider whether any witnesses have prior convictions and determine the probabilities that such convictions will be admissible in the given forum.

VI. SANCTIONS IN THE SEVENTH CIRCUIT

Rule 11 of the Federal Rules of Civil Procedure provides that a lawyer's or a party's signature on any paper filed in district court constitutes a certificate by the signer that the signer has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

Since its amendment in 1983, Rule 11 has been the subject of numerous reported cases nationwide, as well as the topic of frequent commentary and discussion.¹⁷⁰ During the Survey period, the Seventh Circuit addressed Rule 11 many times, and in one *en banc* decision the court finally settled on a standard of appellate review for district court decisions on the issue. This section of the Article will outline the standards for Rule 11 in this circuit, will highlight some procedural developments in the area, and will then briefly set forth some examples of the type of conduct that can invoke the wrath of Rule 11.

A. Standards

Rule 11 proscribes two types of conduct: the filing of frivolous papers and the filing of papers for any improper purpose. The "improper purpose" aspect of the Rule is governed by a subjective standard, while the "frivolousness" clause invokes an objective evaluation.¹⁷¹ The ob-

170. For a brief sampling of articles on the subject, see Carter, *The History and Purposes of Rule 11*, 54 FORDHAM L. REV. 4 (1985); Marcotte, *Rule 11 Changes - Blessing or Curse?*, 72 A.B.A. J. 34 (Sept. 1, 1986); Schwarzer, *Sanctions Under the New Federal Rule 11 - A Closer Look*, 104 F.R.D. 181, 183 (1985); Comment, *Critical Analysis of Rule 11 Sanctions in the Seventh Circuit*, 72 MARQ. L. REV. 91 (1988).

171. See generally *Mars Steel Corp. v. Continental Bank N.A.*, 880 F.2d 928, 933 (7th Cir. 1989). For an in-depth discussion of these aspects of the Rule in the Seventh Circuit, see Comment, *Critical Analysis of Rule 11 Sanctions in the Seventh Circuit*, 72 MARQ. L. REV. 91, 101-07 (1988).

jective analysis for frivolousness asks whether the filer made a reasonable inquiry into the facts and the law.¹⁷² If either the objective or subjective aspect of the Rule is violated, the district court is required to impose a sanction.¹⁷³

In fashioning the appropriate sanction, the district court has discretion to choose from a number of possibilities, including an award of expenses and attorneys fees.¹⁷⁴ As the Seventh Circuit has written, "Available sanctions range from such judicial actions as an off-the-record reprimand to reprimand on the record, to monetary assessments or penalties."¹⁷⁵ The type of sanction should relate to the severity of the violation, and monetary assessments are not necessarily required.¹⁷⁶

While these standards have become settled in the Seventh Circuit in recent years, the appropriate standard for the appellate court to review the district court's decision had been a subject of debate among the panels of the Seventh Circuit itself. Some panels held that a deferential standard of appellate review was appropriate,¹⁷⁷ while others used a *de*

172. See, e.g., *Insurance Benefit Adm'rs Inc. v. Martin*, 871 F.2d 1354, 1357-58 (7th Cir. 1989). The inquiries a district court must make in determining whether an attorney's conduct has violated the frivolousness clause have been summarized by the Seventh Circuit as follows:

To determine whether the attorney made a reasonable inquiry into the facts of a case, a district court should consider: whether the signer of the documents had sufficient time for investigation; the extent to which the attorney had to rely on his or her client for the factual foundation underlying the pleading, motion, or other paper; whether the case was accepted from another attorney; the complexity of the facts and the attorney's ability to do a sufficient pre-filing investigation; and whether discovery would have been beneficial to the development of the underlying facts. . . .

To determine whether the attorney in question made a reasonable inquiry into the law, the district court should consider: the amount of time the attorney had to prepare the document and research the relevant law; whether the document contained a plausible view of the law; the complexity of the legal questions involved; and whether the document was a good faith effort to extend or modify the law.

Brown v. Federation of State Medical Bds., 830 F.2d 1429, 1435 (7th Cir. 1987).

173. Rule 11 specifically states that if a filing is signed in violation of the Rule, "the court, upon motion or upon its own initiative, shall impose . . . an appropriate sanction." FED. R. Crv. P. 11. The Seventh Circuit has indicated that a finding that a sanction is warranted requires only that "some remedial action be taken by the court." *Martin*, 871 F.2d at 1359.

174. See FED. R. Crv. P. 11 (directing court to impose an "appropriate sanction"); *Martin*, 871 F.2d at 1359 (choice of sanction is left to court's discretion).

175. 871 F.2d at 1359.

176. *Id.*

177. See, e.g., *R.K. Harp Investment Corp. v. McQuade*, 825 F.2d 1101, 1103 (7th Cir. 1987); *In re Central Ice Cream Co.*, 836 F.2d 1068, 1072 (7th Cir. 1987); *Borowski v. DePuy Inc.*, 850 F.2d 297, 304 (7th Cir. 1988).

novo standard for some issues.¹⁷⁸ In order to achieve harmony on the issue, the Seventh Circuit heard the issue *en banc* last July in the case of *Mars Steel Corp. v. Continental Bank N.A.*¹⁷⁹

The *Mars Steel* court, by a six to four vote, held that “[f]rom now on, this court will use a deferential standard consistently - whether sanctions were imposed or not, whether the question be frivolousness on the objective side of Rule 11 or bad faith on the subjective side.”¹⁸⁰ Writing for the majority, Judge Easterbrook followed the reasoning of six other courts of appeals that employ deferential review across the board. The thrust of his opinion was that the decision making process on a Rule 11 petition is inherently fact sensitive, and that such evaluations are best handled at the district court level. As he explained: “District Judges have the best information about the patterns of their cases, information appellate judges could duplicate only at great cost in time.”¹⁸¹

While the issue had attracted attention from many, including several bar associations which filed *amicus* briefs,¹⁸² and while it is certainly important, the fact that the matter was finally resolved may well be more significant, in a sense, than the actual resolution that was reached. As one of the lawyers in the case remarked, “From our standpoint, as long as they made a decision, that’s good, [because] [s]ometimes it’s better to decide.”¹⁸³ And as the four judges who would have adopted a *de novo* standard seemed to admit, “[T]he name given to the standard of review may be more symbolic than outcome determinative.”¹⁸⁴

It should be noted that the Supreme Court has agreed to hear the issue of what standards of review are to be used by appellate courts in Rule 11 cases. In fact, as this Article went to press, the Court had just heard argument on the issue in *Cooter & Gell v. Hartmarx*.¹⁸⁵ Should the Court proceed to reach this issue, a decision could be expected before the end of the current term. One of the parties in the Supreme Court case argued that the Court should adopt the deferential standard

178. See, e.g., *Brown v. Federation of State Medical Bds.*, 830 F.2d 1429, 1434 (7th Cir. 1987); *S.A. Auto Lube, Inc. v. Jiffy Lube Int’l Inc.*, 842 F.2d 946, 948 (7th Cir. 1988); *Beeman v. Fiester*, 852 F.2d 206, 209 (7th Cir. 1988).

179. 880 F.2d 928, 930 (7th Cir. 1989).

180. *Id.*

181. *Id.* at 933.

182. The Indiana State Bar Association, for instance, joined with the Seventh Circuit, Illinois State, Chicago Federal, and Chicago bar associations to file a brief supporting a tiered system of review. See 32 RES GESTAE 549, 549-50 (May 1989).

183. CHIC. DAILY L. BULL., July 21, 1989, at 1.

184. 880 F.2d at 940 (Flaum, J., concurring).

185. See summary of argument in 58 U.S.L.W. 3539, 3539-40 (U.S. Feb. 27, 1990) (No. 89-275).

of review embraced by the Seventh Circuit and most other courts of appeals.¹⁸⁶

In any event, the *Mars Steel* decision should be praised on the grounds that it temporarily settles the appropriate standard of appellate review for sanctions cases in the Seventh Circuit. However, the effect of the deferential standard remains to be seen. One of the lawyers in the case opined that practitioners will have to be careful about appealing sanctions issues because the Seventh Circuit is going to rely more on the lower court decision.¹⁸⁷ On the other hand, the judges who voted for *de novo* review argued that uniformity among the circuit's trial judges would be hampered by deferential review.¹⁸⁸

Whatever the standard of review, uniformity will always be lacking because some district judges utilize Rule 11 vigorously, while others control counsel and parties coming before them in other ways. Even though sanctions must be imposed if a violation is found, the trial judge in essence retains the power to bypass this requirement by not finding a violation or by imposing something as light as an off the record reprimand. The standard of appellate review will not change this; only an incredible matrix of "sanctions guidelines" resembling the less than straightforward federal sentencing guidelines could even attempt to do so. In short, trial judges deal with sanctions issues on a case by case basis. To the extent that the *Mars Steel* majority based their holding on this fact, their opinion seems well reasoned.

What, then, is the local practitioner to make of this change? Two suggestions appear warranted. First, so long as careful consideration is given to each filing, which is in essence what Rule 11 reaffirms, there should be no reason for concern. Second, if a specific sanctions issue arises before a district judge, it would be wise to learn that particular jurist's general philosophy on sanctions. Two sources are published opinions on the issue and the everyday reputation of the judge with local practitioners. While uniformity arguably might not exist on different floors of the courthouse, it probably does within any given chambers.

B. Procedural Issues

Several decisions from the Survey period addressed important procedural issues in the sanctions arena. In order to apprise lawyers of these developments, this section of the Article will briefly summarize those holdings. Further analysis of the decisions is left to counsel faced

186. *Id.*

187. CHIC. DAILY L. BULL., July 21, 1989, at 1.

188. 880 F.2d at 940 (Flaum, J., concurring).

with such issues. The more significant teachings can be outlined as follows:

1. There is no due process right to discovery with respect to an imposition of sanctions;¹⁸⁹
2. There is no requirement for a hearing before the imposition of sanctions;¹⁹⁰
3. It is left to the trial court's discretion whether to allow discovery in connection with a Rule 11 award;¹⁹¹
4. Rule 11 is not an affirmative defense that needs to be pleaded in the initial responsive pleading;¹⁹²
5. A Rule 11 motion can be brought after a party reasonably discovers the frivolity or improper purpose of a filing;¹⁹³
6. A district court faced with possible sanctions under its various powers such as Rule 11, Rule 37, and U.S. Code Title 18 section 1927 must state the authority upon which it makes each sanction so that review may be had accordingly;¹⁹⁴
7. Although the district court need not issue long, detailed orders in every sanctions case, the district court must state with some specificity the reasons for the imposition of the sanction and the manner in which the sanction was computed, with the award being quantifiable with some precision and properly itemized in terms of the perceived misconduct and the sanctioning authority;¹⁹⁵
8. Sanctions may be imposed on a *pro se* litigant;¹⁹⁶
9. When attorneys are sanctioned, they can appeal under the collateral order doctrine prior to final judgment in the underlying litigation if the order appealed from conclusively determined the disputed sanctions question;¹⁹⁷

189. *Borowski v. DePuy, Inc.*, 876 F.2d 1339, 1341 (7th Cir. 1989).

190. *Id.* One commentator has noted that discovery or a full-blown evidentiary hearing is allowed only under extraordinary circumstances. See Comment, *Critical Analysis of Rule 11 Sanctions in the Seventh Circuit*, 72 MARQ. L. REV. 91, 111 (1988).

191. *Borowski*, 876 F.2d at 1343 (Cudahy, J., concurring in part and dissenting in part).

192. *Seehawer v. Magnecraft Elec. Co.*, 714 F. Supp. 910, 916 (N.D. Ill. 1989) (in striking an affirmative defense that in essence pleaded the text of Rule 11, the court, after noting no cases had been located on the issue, held that "Rule 11 cannot by itself constitute an affirmative defense.").

193. *Id.* (noting that placing a burden on defendants to affirmatively plead Rule 11 sanctions in their answer could effectively deny relief to those defendants who reasonably discover the violation of the Rule long after the initial pleadings phase).

194. *Insurance Benefit Adm'rs, Inc. v. Martin*, 871 F.2d 1354, 1361 (7th Cir. 1989).

195. *Id.* at 1362.

196. *Goldberg v. Weil*, 707 F. Supp. 357, 362 (N.D. Ill. 1989).

197. *Rogers v. National Union Fire Ins. Co.*, 864 F.2d 557, 559 (7th Cir. 1988) (citing *Frazier v. Cast*, 771 F.2d 259 (7th Cir. 1985)).

10. When non-party attorneys appeal a sanctions order, they must name themselves on the notice of appeal as they are the real party in interest as to the sanctions appeal; failure to do so is not excusable because it deprives the appellate court of jurisdiction;¹⁹⁸
11. The finality of an order in the underlying litigation is *not* affected by the pendency of a motion for sanctions,¹⁹⁹ and,
12. Withdrawal of a frivolous complaint or a frivolous appeal does not prevent an award of sanctions.²⁰⁰

Procedural matters such as these will no doubt continue to receive courts' attention as the law of sanctions develops in this circuit.

The most important procedural ruling on Rule 11 in the national arena was handed down by the Supreme Court in late 1989. In *Pavelic & Leflore v. Marvel Entertainment Group*,²⁰¹ the Supreme Court held that Rule 11 sanctions may be imposed only upon individual attorneys or parties who sign papers and not on law firms. In writing for the eight-member majority, Justice Scalia determined that Rule 11's language is unambiguous and must be given its plain meaning.

Specifically, Scalia wrote that when Rule 11 says that a sanction is to be imposed "upon the person who signed it. . . , " it means that the individual who signed the paper is the party responsible for the sanction. This is so, the Court ruled, because Rule 11 mandates that every pleading, motion, or paper must be signed by the attorney, and that signature constitutes a certificate by the signer that the paper is well grounded in fact and law. Moreover, the Court noted that holding individual attorneys liable for their own conduct better serves the deterrence purposes of Rule 11.²⁰²

198. *Rogers*, 864 F.2d at 559-60; *Federal Trade Comm'n v. Amy Travel Serv., Inc.*, 875 F.2d 564, 566 (7th Cir. 1989); *Reynolds v. East Dyer Dev. Co.*, 882 F.2d 1249 (7th Cir. 1989).

199. *Cleveland v. Berkson*, 878 F.2d 1034, 1036 (7th Cir. 1989) (noting that the issue had not been squarely addressed in the Seventh Circuit).

200. *Margulin v. CHS Acquisition Corp.*, 889 F.2d 122 (7th Cir. 1989).

201. 110 S. Ct. 456 (1989).

202. 110 S. Ct. at 458-60. The decision in *Melrose v. Shearson/American Cypress Inc.*, No. 88-2008, 2260, slip op. (7th Cir. Dec. 29, 1989) is interesting in that the Seventh Circuit affirmed an award of sanctions against a law firm in *Melrose*, just 24 days after the Supreme Court's decision in *Pavelic & Leflore*. The *Melrose* court, however, did not initially cite to *Pavelic & Leflore* or in any other fashion indicate an awareness of the Supreme Court's holding. It must be presumed, then, that neither the parties nor the Seventh Circuit were aware of the new Rule 11 decision placing liability for sanctions on attorneys rather than firms. However, on February 8, 1990, the Seventh Circuit issued an amended opinion discussing the effect of *Pavelic*. The court noted that it was unclear whom the district court had sanctioned when it stated that sanctions were awarded against

C. Examples of Sanctionable Conduct

Given that there will probably never be any concise set of abstract rules for sanctions due to the fact sensitive nature of the inquiry,²⁰³ it is appropriate to sample the types of conduct that have invoked the wrath of the courts under Rule 11. Another laundry list reveals the following sanctionable activity during the Survey period:

1. Sanctions were awarded and affirmed where a motion to reconsider contained no new evidence or arguments;²⁰⁴
2. Sanctions were awarded and affirmed for an attorney's *ex parte* communication with a magistrate;²⁰⁵
3. Sanctions were awarded where a patentholder's attorney failed to conduct a reasonable prefiling inquiry to determine whether distributors could have sold allegedly infringing devices;²⁰⁶
4. Summary judgment was reversed and remanded for consideration of sanctions where the defense counsel presumably had knowledge of a genuine issue of material fact precluding summary judgment;²⁰⁷
5. Sanctions were imposed on a party for filing a frivolous request for sanctions;²⁰⁸ and,
6. Counsel for an appellant was sanctioned where an appeal was found to be frivolous under Rule 38 of the Federal Rules of Appellate Procedure. The court specifically assessed the sanction against the attorney because it found his brief to be comprised of misleading arguments and legally inaccurate propositions.²⁰⁹

"Shearson's counsel." The Seventh Circuit thus remanded the case to determine which attorneys from the firm were liable. The Seventh Circuit made clear that after *Pavelic & Leflore*, individual attorneys are the ones accountable under Rule 11, even if they purport to sign on their firm's behalf. *Id.*

203. *Mars Steel Corp. v. Continental Bank, N.A.*, 880 F.2d 928, 933 (7th Cir. 1989).

204. *Magnus Elec., Inc. v. Masco Corp.*, 871 F.2d 626, 630 (7th Cir. 1989) (sanction award made by Judge Duff of the Northern District of Illinois).

205. *Id.* at 632.

206. *Autotech Corp. v. NSD Corp.*, 125 F.R.D. 464 (N.D. Ill. 1989).

207. See *supra* notes 138-44 and accompanying text.

208. *Foy v. First Nat'l Bank of Elkhart*, 868 F.2d 251, 258 (7th Cir. 1989) (involving sanctions at appellate level under FED. R. APP. P. 38).

209. *Williams v. United States Postal Serv.*, 873 F.2d 1069, 1075 (7th Cir. 1989). See also *Gorenstein Enter. v. Quality Care-USA*, 874 F.2d 431, 437-38 (7th Cir. 1989) (frivolous appeal); *Ross-Berger Cos. v. Equitable Life Assurance*, 872 F.2d 1331, 1340-41 (7th Cir. 1989). In several other opinions the Seventh Circuit, on its own motion, chastized counsel for filing inadequate briefs. In one case, for instance, Judge Posner

Finally, in perhaps the most instructive opinion of the Survey period in this area, the Seventh Circuit denied an otherwise meritorious motion for sanctions under Rule 38 of the Federal Rules of Appellate Procedure where the party seeking sanctions filed a full-fledged brief on the merits. In *Brooks v. Allison Division of General Motors*,²¹⁰ the employer had successfully obtained summary judgment at the district court on a fair representation and employment discrimination claim. In disposing of the claims, Judge Steckler relied on the fact that the complaint was clearly untimely because it was filed more than five years after the alleged discrimination and four years after the EEOC's right to sue letter.²¹¹

Nonetheless, the plaintiff appealed *pro se*. His appellate brief neither cited legal authorities nor specified error in the district court's decision. The one-page narrative of argument constituted a "naked" submission and was deemed frivolous *per se* by the Seventh Circuit. Accordingly, the employer asked for sanctions.²¹²

The Seventh Circuit, however, denied the request for sanctions for the sole reason that the employer had filed a full-fledged printed brief on the merits. The Seventh Circuit found this to be "a waste of General Motors' money and [the court's] time." The court noted that a sanction for a frivolous filing is in the nature of a tort remedy for negligence, and that as such the victim must take reasonable steps to mitigate its damages. Accordingly, the court found that the full-fledged brief was unnecessary in such a case and denied the motion for sanctions for failure to mitigate damages.²¹³

wrote the following:

A brief observation, finally, on the brief submitted to this court by [plaintiff's] counsel, Mr. Burt L. Dancey of Pekin, Illinois. The brief is execrable. The argument portion is a paltry six pages of extra-large type, with nary a citation. Mr. Dancey was heard to grumble that this court had allotted him a mere ten minutes to present his argument. He was lucky that we did not dismiss the appeal for failure to present issues properly. It is not enough for an appellant in his brief to raise issues; they must be pressed in a professionally responsible fashion. See *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1025-26 (7th Cir. 1988) (collecting cases). That was not done here, and we warn that the penalty for a perfunctory appeal brief can be dismissal of the appeal. *Mitchel v. General Elec. Co.*, 689 F.2d 877 (9th Cir. 1982).

Pearce v. Sullivan, 871 F.2d 61, 64 (7th Cir. 1989). See also Jones v. Hamelman, 869 F.2d 1023, 1032 (7th Cir. 1989) (court writing that it is not "unreasonable to expect carefully drafted briefs clearly articulating the issues and the precise citation of relevant authority for the points in issue . . ."); Cochran v. Celotex Corp., 125 F.R.D. 472, 473-74 (C.D. Ill. 1989) (openly chastising counsel for writing an *ex parte* letter to the court).

210. 874 F.2d 489 (7th Cir. 1989).

211. *Id.* at 490.

212. *Id.*

213. *Id.* at 490-91.

The *Brooks* opinion is important because it reconfirms that the whole purpose of the rules providing for sanctions is to expedite the disposition of cases. As the Seventh Circuit said in *Mars Steel*, "The duty to the legal system [imposed by such rules] is to avoid clogging the courts with paper that wastes judicial time and thus defers the disposition of other cases, or by leaving judges less time to resolve each case, increasing the rate of error."²¹⁴ According to the Seventh Circuit, an action such as the filing of a full-blown brief on the merits in a frivolous case such as *Brooks* thwarts the very purpose of the sanctions rules.

VII. APPELLATE ISSUES

Finally, there were several developments relating to appeals that should be noted. First, in *Torres v. Oakland Scavenger Co.*,²¹⁵ the Supreme Court held that the courts of appeals cannot waive the jurisdictional requirement that parties be named in an appeal, even for good cause shown. In that case the district court dismissed a discrimination action filed by Torres and 15 other plaintiffs. Their attorney timely appealed. However, in preparing the notice of appeal, the lawyer's secretary, through a clerical error, failed to name Torres as an appellant. The Ninth Circuit accordingly held that it lacked jurisdiction over Torres' claim under Rule 3(c) of the Federal Rules of Appellate Procedure.²¹⁶

Resolving a split in the circuits on this issue, the Supreme Court held that Rule 3(c)'s requirement that the notice of appeal "shall specify the party or parties taking the appeal" is *mandatory and jurisdictional*.²¹⁷ The Court went so far as to reject the argument that the attorney's use of "*et al.*" in the notice was sufficient for Torres,²¹⁸ even though there was arguably no prejudice to the appellee as a result.²¹⁹

The *Torres* decision was immediately felt in the Seventh Circuit. For instance, in one case the court dismissed an appeal of a sanctions award against an attorney where the attorney had not named himself as the real party in interest in the notice of appeal.²²⁰ The Seventh Circuit relied on *Torres* and rejected the argument that the court had any

214. *Mars Steel Corp. v. Continental Bank, N.A.*, 880 F.2d 928, 932 (7th Cir. 1989).

215. 108 S. Ct. 2405 (1988).

216. 108 S. Ct. at 2407.

217. *Id.* at 2407-08.

218. *Id.* at 2409.

219. *Id.* at 2410 (Brennan, J., dissenting).

220. *Federal Trade Comm'n v. Amy Travel Serv., Inc.*, 875 F.2d 564 (7th Cir. 1989). In early 1990, however, the Seventh Circuit held that *Torres* did not govern where a notice of appeal failed to accurately set forth the judgment or order from which appeal was taken. See *Chaky v. Lare*, No. 89-3151, slip op. (7th Cir. Feb. 1, 1990).

discretion to disregard the omission of the attorney's name from the notice of appeal.

Other decisions of importance include the following:

1. The Supreme Court resolved a conflict in the circuits by holding that a district court's decision on the merits is a "final decision" from which appeal must be timely taken even though the recoverability of attorneys fees remains to be decided in the district court;²²¹
2. A party obtaining dismissal of an opponent's claim has standing to appeal insofar as the dismissal is without prejudice; such a party is aggrieved in a practical sense because there can be further litigation on the issue unless the dismissal is with prejudice;²²²
3. Aggrieved parties are to appeal from the final order or judgment rather than the order on a post-judgment motion; however, an appeal from such a post-judgment motion will be allowed when:
 - a. The judgment intended to be appealed is final;
 - b. It is clear what judgment is involved;
 - c. The motion and appeal were timely, and;
 - d. There is no prejudice to the other party;²²³
4. A district court is without power to extend the short time period for making or serving a motion to alter or amend judgment under Federal Rule of Civil Procedure 59(e), and an untimely 59(e) motion does not toll the time for filing appeal;²²⁴
5. A failure to object to a Magistrate's report made under a special master reference operates as a waiver of the right to object on appeal;²²⁵ and,
6. A motion for prejudgment interest filed after entry of judgment operates as a Rule 59 motion to alter or amend judgment. Thus, under Appellate Rule 4(a)(4), a notice of appeal filed during the pendency of such a prejudgment interest motion is void.²²⁶

221. *Budinich v. Becton Dickinson & Co.*, 108 S. Ct. 1717 (1988).

222. *Disher v. Information Resources, Inc.*, 873 F.2d 136, 139 (7th Cir. 1989); *LaBuhn v. Bulkmatic Transp. Co.*, 865 F.2d 119, 121-22 (7th Cir. 1988).

223. *Petri v. City of Berwyn*, 872 F.2d 1359, 1361 (7th Cir. 1989).

224. *Green v. Bisby*, 869 F.2d 1070, 1072 (7th Cir. 1989). This point has been settled for some time, but seems to be a common trap for the unwary. The dismal result is that neither the district court nor the court of appeals has any jurisdiction.

225. *Provident Bank v. Manor Steel Corp.*, 882 F.2d 258 (7th Cir. 1989), *reh'g en banc den.*

226. *Osterneck v. Ernst & Whitney*, 109 S. Ct. 987 (1989).

Finally, on the procedural level, the Seventh Circuit added a new rule governing notices of appeal. The most significant change made by new Circuit Rule 3(c) is the requirement that the appellant must serve a jurisdictional statement on all opposing parties *at the time of filing the notice of appeal.*²²⁷ The purpose of this new rule "is to allow the court of appeals to screen its incoming appeals for jurisdictional defects at an early stage of the appellate process."²²⁸ This changes former practice under which the first jurisdictional statement was not required until the filing of the briefs.

New Circuit Rule 3(c) will also likely provide a good deterrent effect because it will force counsel to pin down the jurisdictional foundation for their appeal at an early stage, thus increasing the chances that an inappropriate appeal will be discovered by the aggrieved party before appeal rather than by the opponent and the court at a later date.

To date, the Seventh Circuit has taken a stern approach to Circuit Rule 3(c). For instance, in *Despenza v. O'Leary*,²²⁹ the court dismissed the appeals of *pro se* litigants who failed to file timely jurisdictional statements pursuant to Circuit Rule 3(c), and who failed to comply with show cause orders requiring such statements within 14 days. In its two paragraph *per curiam* opinion, the *Despenza* court did not discuss the Rule at any length, but instead treated it as a jurisdictional prerequisite.²³⁰

The *Despenza* case and new Rule 3(c) show once again that the Seventh Circuit requires strict compliance with its rules. Practitioners filing appellate briefs in the Seventh Circuit must scrutinize an up-to-date version of the Appellate and Circuit Rules and ensure that each and every rule is followed.

227. This portion of the new rule reads as follows:

The appellant must serve on all parties a jurisdictional statement and file it with the clerk of the district court at the time of the filing of the notice of appeal or with the clerk of this court within seven days of filing the notice of appeal. The jurisdictional statement shall comply with the requirements of Circuit Rule 28(b). If the appellee disagrees with the jurisdictional statement in that it is not complete and correct, the appellee shall provide a complete one to the court of appeals clerk within 21 days after the date of the filing of the notice of appeal.

Seventh Circuit Rule 3(c).

228. Memorandum from Thomas F. Strubbe to Circuit Rules Recipients (Jan. 24, 1989) (on file in the *Indiana Law Review* office).

229. 889 F.2d 113 (7th Cir. 1989).

230. In a sharply worded dissent, Judge Ripple argued that the majority's decision was unnecessarily harsh because parties represented by counsel are given two opportunities to comply with the Rule. 889 F.2d at 114-15 (Ripple, J., dissenting).

Survey of Recent Developments in Indiana Criminal Law and Procedure

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"I know no safe depository of the ultimate powers of the society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them, but to inform their discretion by education."¹

The Indiana courts, buttressed by the fervor generated by the recent "war on drugs" and the general hostility toward criminal defendants, continued to curtail defendants' rights in cases decided this survey period. Criminal defense attorneys are facing new challenges to traditional tenets of criminal law,² and in order to be successful are required to develop new and creative arguments. This Article is designed to aid the practicing attorney by analyzing recent developments in criminal law.

I. CONFRONTATION ISSUES

A. Child Sexual Abuse Cases: The Admissibility of Out of Court Statements

A continuing issue during this survey period is the admissibility of out-of-court statements of "child victims" which form the basis for

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1. Thomas Jefferson.

2. *See, e.g.*, Bergfeld v. State, 531 N.E.2d 486 (Ind. 1988). The Indiana Supreme Court held that a warrantless search of motel premises was justified because the police officers had probable cause to believe a crime had been or was being committed in the motel room and, therefore, exigent circumstances legitimized the warrantless search, despite the fact that one defendant was already in custody. Justice Shepard, dissenting, called this decision a "rogue far enough outside the mainstream of fourth amendment jurisprudence that it will not serve as precedent." *Id.* at 495. *See supra* section II for a detailed discussion on search and seizure.

child sexual abuse prosecutions. Often these statements comprise the state's primary evidence. Compounding the difficulty inherent in trying cases in this area is that often the alleged victim is under the age of ten and is therefore presumed to be incompetent,³ and the state is unable to rebut that presumption.

A statute enacted in 1984⁴ provides that if certain requirements are met, "statements or videotapes" made by a child/victim are admissible in the trial.⁵ The statute, known as the child hearsay statute,⁶ has been at the center of many important cases decided during this survey period; this section will concentrate primarily on those decisions and the resulting impact upon confrontation analysis.

The child hearsay statute provides for the admission of a "statement or videotape" contingent upon the following conditions: The child must be under the age of ten; the statement must contain allegations of an act which is a material element of the purported crime committed against the child; the statements of the child must be otherwise inadmissible; and, if the child is unavailable, as determined at a pretrial hearing attended by the child and defendant, at which the accused is afforded the full right to cross-examine and confront the witness, there must be corroborative evidence of the act.⁷ Additionally, before the pretrial statement can be used, the trial court must determine "that the time, content,

3. IND. CODE § 34-1-14-5 (1988) governs the competence of witnesses in criminal cases through its incorporation of IND. CODE § 35-37-4-1 (1988). It provides in part: "The following persons shall not be competent witnesses: . . . Children under ten [10] years of age, unless it appears that they understand the nature and obligation of an oath." IND. CODE § 34-1-14-5 (1988).

4. IND. CODE § 35-37-4-6 (1988). The statute was enacted in 1984 by Public Law 180-1984.

5. *Id.*

6. *Id.*

7. The relevant parts of IND. CODE § 35-37-4-6 read as follows:

Sec. 6. (a) This section applies to criminal actions for the following:

(1) Child molesting (IC 35-42-4-3).

* * *

(b) A statement or videotape that:

(1) is made by a child who was under ten (10) years of age at the time of the statement or videotape;

(2) concerns an act that is a material element of an offense listed in subsection (a) that was allegedly committed against the child; and

(3) is not otherwise admissible in evidence under statute or court rule; is admissible in evidence in a criminal action for an offense listed in subsection (a) if the requirements of subsection (c) are met.

(c) A statement or videotape described in subsection (b) is admissible in evidence in a criminal action listed in subsection (a) if, after notice to the defendant of a hearing and of his right to be present:

and circumstances of the statement or videotape provide sufficient indications of reliability.”⁸

The Indiana Supreme Court determined in *Miller v. State*⁹ (“*Miller I*”) that the fact that a child is incompetent to testify at trial does not vitiate the statutory mandate that the child testify and be subject to cross examination at some point during the progress of the case through the judicial system.¹⁰ The court held that the confrontation clauses of the United States Constitution¹¹ and the Indiana Constitution¹² separately require that the defendant be accorded some opportunity, either at trial or in a pretrial hearing, to confront his accuser.¹³ However, *Miller I* left the requirements of the child hearsay statute somewhat unclear.

The parameters of the child hearsay statute were clarified by the court in *Miller v. State*¹⁴ (“*Miller II*”). There, the court held that the state’s failure to produce the child at the hearing to determine the admissibility of the statements or videotapes and the failure to produce the child at the trial constitutes a denial of the defendant’s right to confrontation.¹⁵ The court determined that even if the child is found to

-
- (1) the court finds, in a hearing:
 - (A) conducted outside the presence of the jury; and
 - (B) attended by the child; that the time, content, and circumstance of the statement or videotape provide sufficient indications of reliability; and
 - (2) the child:
 - (A) testifies at the trial; or
 - (B) is found by the court to be unavailable as a witness because:

* * *

- (iii) the court has determined that the child is incapable of understanding the nature and obligation of an oath.

- (d) If a child is unavailable to testify at the trial for a reason listed in subsection (C)(2)(B), a statement or videotape may be admitted in evidence under this section only if there is corroborative evidence of the act that was allegedly committed against the child.

8. IND. CODE § 35-37-4-6 (c) (1988).

9. 517 N.E.2d 64 (Ind. 1987).

10. *Id.* Indeed, any holding to the contrary would violate the defendant’s right to confrontation, as guaranteed by the federal and Indiana constitutions. *See supra* notes 11-12.

11. The sixth amendment to the United States Constitution reads “In all criminal prosecutions, the accused shall enjoy the right . . . to be confronted with the witnesses against him. . . .” U.S. CONST. amend. VI.

12. Article I, section 13 of the Indiana Constitution reads “In all criminal prosecutions, the accused shall have the right . . . to meet the witnesses face to face . . .” IND. CONST. art. I, § 13.

13. 517 N.E.2d at 71, 74.

14. 531 N.E.2d 466, 470 (Ind. 1988).

15. *Id.*

be an incompetent witness, cross-examination must be afforded the defendant.¹⁶

Furthermore, as emphasized in *Miller II*,¹⁷ there is an independent right to confrontation under the Indiana Constitution. Article I, section 13 of the Indiana Constitution reads "In all criminal prosecutions, the accused shall have the right to . . . meet the witnesses face to face."¹⁸ The emphasis on the state constitutional right to confrontation in both *Miller I* and *Miller II* clarifies the difference between the federal confrontation clause and the state. The explicit language of the two clauses may symbolize a difference in the rights secured. The federal confrontation clause does not contain explicit language mandating a face-to-face confrontation, whereas the Indiana language is explicit.¹⁹

While the court in both *Miller* cases found that there are state and federal constitutional underpinnings to its decision, the court concentrated on the state right to confrontation. Consequently, in *Miller II*, the court relied only in small part upon the recent case of *Coy v. Iowa*,²⁰ where the United States Supreme Court affirmed that the words "confronted with the witnesses against him" in the sixth amendment means the defendant must be allowed to meet his accusers literally face-to-face.²¹

Applying an analysis that concentrates on the interpretation of the confrontation clause in the Indiana constitution, the court in *Miller II* held that under the child-hearsay statute,²² the failure of the state to have present the incompetent child-victim at the hearing to determine the admissibility of the proffered out-of-court statements would deny

16. *Id.*

17. 531 N.E.2d at 470.

18. IND. CONST. art. I, § 13.

19. The age-old question which has haunted those attempting to determine what rights the federal confrontation clause embodies is whether the sixth amendment was intended to guarantee literal rights to the defendant, or merely to act as a general rule which assures the defendant the opportunity for a fair trial, via cross-examination. If the confrontation clause does guarantee a literal right, is the right absolute or may there be an exception to this right? The United States Supreme Court is split on this topic. See *Coy v. Iowa*, 108 S. Ct. 2798 (1988). See also J. WIGMORE, EVIDENCE § 1395 (1975). Wigmore's position is that the confrontation clause primarily serves to guarantee the defendant a fair trial, and cross-examination is the means to do so. *Id.* at § 1396.

20. 108 S. Ct. 2798 (1988).

21. 108 S. Ct. at 2800. In *Coy*, at issue was the propriety of a state statute that provided for a screen to be placed between the defendant and the complaining witness. The witness could not see the defendant while testifying, but the defendant could view the witness. The Court held that the right to "confront" witnesses guaranteed the defendant a face-to-face meeting, and thus the use of the screen as a mechanism to circumvent this right was unconstitutional. *Id.* at 2803.

22. IND. CODE § 35-37-4-6 (1988).

the defendant his right to confront his accusers face-to-face, as guaranteed by the Indiana Constitution.²³

Interestingly, the Indiana Court of Appeals in *Brady v. State*²⁴ held that *Coy* and the sixth amendment did not require in all cases the defendant be afforded an opportunity to meet his accusers face-to-face.²⁵ Citing Justice O'Connor's concurring opinion in *Coy*, that the right to face one's accusers is not absolute, the court in *Brady* held that "the protection of child witnesses in cases such as this is a state interest compelling enough to override a defendant's right to a face-to-face confrontation, provided the procedural safeguard of finding need on case-by-case basis is required and adhered to."²⁶

In *Brady*, the videotaped session of the child's statement took place with the child in her own house, with the defendant stationary in the garage watching the interview via television monitor.²⁷ The only way the defendant could communicate with his attorney was through a two-way radio.²⁸ The attorneys used flashcards to indicate objections.²⁹

These procedures hardly afford the defendant his right to confront the witnesses in a "full adversarial proceeding" at some point in the proceedings. On appeal, the defendant in *Brady* argued that this procedure violated his right to confrontation, and lost.³⁰

Narrowly interpreting *Miller I*, the court in *Brady* concluded that because cross examination is the right primarily protected by the confrontation clause, the statute which provides for videotaping a child-

23. *Miller v. State*, 531 N.E.2d at 470. The meaning of the right to confrontation in the context of the child-hearsay statute was best analyzed by Chief Justice Shepard in *Miller I*. He wrote:

The documented history of the Indiana statute, although lean, indicates the legislature intended that the hearing on the admissibility of a child victim's statement be adversarial in nature with full confrontation between Defendant and victim. The legislature intended that the child testify during the hearing, even if the child will be unavailable for trial.

517 N.E.2d at 70. By enacting the child-hearsay statute, the legislature did not intend to circumscribe the defendant's right to confrontation. The legislature provided for the defendant to exercise his right by assuring that either the child would be present and testify at the hearing, allowing the defendant to inquire into the child's statements, or by having the child testify at trial.

24. 540 N.E.2d. 59 (Ind. Ct. App. 1989).

25. *Id.* at 65.

26. *Id.* In *Brady*, the defendant challenged the constitutionality of Indiana Code section 35-37-4-8, which provides for the videotaping of a child's testimony in lieu of live testimony at trial.

27. *Id.*

28. *Id.* at 66.

29. *Id.*

30. *Id.*

witness' testimony in lieu of live testimony is constitutional because it allows the defendant an opportunity to cross-examine, albeit outside the vision of the child if the defendant is represented by an attorney.³¹ No literal face-to-face confrontation is required.³²

It is difficult to justify *Brady* in light of the clear language of the Indiana Supreme Court in *Miller I* and the specific language of the Indiana Constitution. In *Miller I* the court interpreted the child-hearsay statute as preserving the defendant's right to confrontation through cross-examination, fully adversarial in nature, at some point in the proceedings and attended by the defendant.³³ Moreover, the Indiana Constitution specifically imbues criminal defendants with the right to confront their accusers face-to-face.³⁴ And while the confrontation clause in the sixth amendment only implies this right, in *Coy* the Supreme Court interpreted the clause to require a face-to-face confrontation.³⁵

Thus, the long-term significance of *Miller I* and *Miller II* is the emphasis by the court on the state constitutional right to confront accusers face-to-face. Article I, section 13 requires no less. As the United States Supreme Court eviscerates federal rights, the movement toward expanding rights under the state constitution is of critical importance.³⁶

B. *The Reliability Requirement*

The child hearsay statute mandates a separate inquiry into the reliability of the proffered statements.³⁷ However, until *Miller II*,³⁸ there were few, if any, decisions indicating what was meant by the terms of the statute, which require the court to determine "that the time, content, and circumstances of the statement or videotape provide sufficient indications of reliability."³⁹ The statute seems to require a "probe" into the "internal" reliability of the statements.

31. *Id.*

32. *Id.*

33. *Miller v. State*, 517 N.E.2d 64 (Ind. 1987).

34. IND. CONST. art. I, § 13.

35. *Coy v. Iowa*, 108 S. Ct. 2798 (1988).

36. See also *Lee v. State*, 538 N.E.2d 983 (Ind. Ct. App. 1989) and *Crull v. State*, 540 N.E.2d 1195 (Ind. 1989). In *Lee*, the court determined that for a description of the right to confrontation in a guilty plea, advice that you have the right to meet accusers in court and have them face you is sufficient. 538 N.E.2d at 986. This lends further support to the contention that under the Indiana Constitution, the right to confrontation requires a face-to-face meeting and not just the opportunity to cross examine. In *Crull*, the Indiana Supreme Court determined that on cross-examination a witness must state where he/she currently lives and works, and the state must demonstrate actual threats, and not vague fears before the scope of cross will be limited. 540 N.E.2d at 1199.

37. IND. CODE § 35-37-4-6(c)(1)(B) (1988).

38. *Miller v. State*, 531 N.E.2d 466 (Ind. 1988).

39. IND. CODE § 35-37-4-6(c) (1988).

The "internal reliability" requirement provided for in the statute is of critical importance. Often police authorities use techniques which are improper and even damaging in their questioning of child witnesses. These techniques are not limited to the police and there have been many documented abuses by social workers, and other "child protection" agencies.⁴⁰ The method used by interviewers in assessing the situation often contaminates and reduces the reliability of a child's statements.⁴¹ Only upon close scrutiny of the time, content and circumstances surrounding the statement can a court be sure that the statement contains sufficient indicia of reliability upon which to base its admission.

In *Miller II* the court held that based upon its independent review of the record, the child's statements were not reliable because of the manner of questioning used by the police and social workers.⁴² The facts indicate that the child was three years old and "under intense control and scrutiny from 11:00 a.m. until the statement at 6:45 p.m."⁴³ During that time, not only was she subjected to a physical examination by a strange doctor, but she was also taken to the welfare department and then to the sheriff's office to be confronted by more strangers asking her questions.⁴⁴ The court stated: "One cannot imagine a more exhausting, stressful, and coercive situation. The questioning did not commence by drawing the child's attention to her injury and then posing non-suggestive questions to get the child to reveal the source of that injury."⁴⁵ Hence, the court concluded that the circumstances surrounding the making of the statement provided insufficient indicia of reliability and thus its admission was not adequately supported.⁴⁶

What occurred in *Miller II* was that a statement made by a child after intense, carefully orchestrated questioning, maybe even rehearsal, designed to elicit the desired results, was used against a defendant in a child abuse case. However, the legitimate need to protect young witnesses from unnecessary trauma cannot be used to abrogate all of the defendant's rights. As the court in *Miller II* recognized, "It seems

40. Ralph Underwager, M.Div., Ph.D., a noted expert in the field of assessing child abuse cases, noted "[u]nfortunately, the way children are currently being interviewed may not result in obtaining the truth about what really happened. The story that is told often is the one the interviewer wants to hear." The Role of the Psychologist in the Assessment of Cases of Alleged Sexual Abuse of Children, presented at the 94th Annual Convention of the American Psychological Association, Washington D.C., August, 1986, prepared by the Institute for Psychological Therapies.

41. *Id.*,

42. *Miller v. State*, 531 N.E.2d 466, 470-71 (Ind. 1988).

43. *Id.* at 470.

44. *Id.*

45. *Id.*

46. *Id.* at 471.

unfailingly important that in weighing the value of the child's statement the trier of fact have the opportunity to consider the child's responses when questioned by someone other than a sympathetic interviewer.⁴⁷

II. ARRESTS, SEARCHES AND SEIZURES

In *Bergfeld v. State*,⁴⁸ the Indiana Supreme Court held a warrantless search of a motel room justified because the officers had probable cause to believe a crime had been or was being committed, and exigent circumstances legitimized the ensuing search.⁴⁹ In plain words, the majority found exigent circumstances in mere probable cause, contrary to the warrant requirement.

In *Bergfeld*, a "drug dealer, drug user, prostitute, exotic dancer, and one time former police informant" reported to police that she had been abducted by the defendant, her boyfriend, and his friend Orth, taken to a motel room, forced to use cocaine, and repeatedly raped.⁵⁰ After she escaped, she called the police and reported the incident.⁵¹ An officer was dispatched to her home, and another dispatched to the motel.⁵² The officer at the motel had the clerk call the room to ask whether they planned to check out or stay another day. The defendant told the clerk he was staying another day and would come to the desk to pay. Thereafter, the police, who had surrounded the room, observed the defendant drive away in an automobile.⁵³

The police immediately signaled the defendant to stop, but instead he accelerated and shortly thereafter was forced off the road by other officers.⁵⁴ Upon exiting the car, police observed a handgun in the defendant's back pocket. The defendant was arrested and taken back to the motel.⁵⁵

At the motel, three police officers knocked on the motel room door with their weapons drawn, without a search warrant.⁵⁶ A man later identified as Orth eventually opened the door, after repeated requests by the police to do so, and the officers then made a forced unwarranted

47. *Id.*

48. 531 N.E.2d 486 (Ind. 1988) (Givan, J., writing for the majority).

49. *Id.* at 490.

50. *Id.* at 493 (DeBruler, J., dissenting).

51. *Id.* at 489.

52. *Id.*

53. *Id.*

54. *Id.*

55. The defendant was ultimately convicted for possession with intent to deliver cocaine, possession of Diazepam, and carrying a handgun without a license. *Id.*

56. Justice DeBruler, dissenting, emphasized that the police officers had not even attempted to get a search warrant. *Id.* at 494.

entry into the room.⁵⁷ Once inside, the officers observed scales with a white powder on it and arrested Orth.⁵⁸

The defendant argued on appeal that the trial court erred in denying his motion to suppress the evidence found in the motel room, contending that not only was there no probable cause for his arrest, but also that the warrantless search of the motel room violated his right against unreasonable searches and seizures guaranteed by the fourth amendment.⁵⁹

In a decision characterized by Justice Shepard⁶⁰ in his dissent as a "rogue, far enough outside the mainstream of fourth amendment jurisprudence that it will not serve as precedent," the majority concluded the warrantless entry proper because of the combination of two factors: probable cause and exigent circumstances.⁶¹ The majority reasoned that because the defendant and Orth still occupied the room, exigent circumstances existed.⁶²

The fact that police may have probable cause to believe an offense has been or is being committed is not an exception to the warrant requirement.⁶³ The *Bergfeld* opinion is contrary to the basic constitutional rule that "searches conducted outside the judicial process, without prior approval by judge or magistrate, are *per se* unreasonable under the fourth amendment - subject only to a few specifically established and well-delineated exceptions."⁶⁴ Thus, *Bergfeld* represents such a radical departure from traditional fourth amendment analysis that its value as precedent is questionable.

In another case apparently outside the mainstream of fourth amendment law, the Indiana Court of Appeals, in *Snyder v. State*,⁶⁵ held that

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 495.

61. *Id.* at 490.

62. As Justice DeBruler in his dissent correctly points out, the defendant was in fact not in the room, but rather was already in police custody. *Id.* at 493-94 (DeBruler, J., dissenting). Furthermore, there was no reasonable basis for the police to believe that Orth was going to flee or destroy evidence. Quite the contrary: the occupants of the room had indicated their desire to stay another night, and Orth had no knowledge of the defendant's arrest. *Id.* Probable cause is not the equivalent of exigent circumstances.

63. *Coolidge v. New Hampshire*, 403 U.S. 443 (1971); *Robles v. State*, 510 N.E.2d 660 (Ind. 1987). In order to justify a warrantless entry and search of a residence, exigent circumstances must exist in addition to probable cause. Exigent circumstances include: "(1) risk of bodily harm or death; (2) to aid a person in need of assistance; (3) to protect private property; (4) actual or imminent destruction or removal of evidence before a search warrant may be obtained." *Sayre v. State*, 471 N.E.2d 708 (Ind. Ct. App. 1984).

64. *Coolidge*, 403 U.S. 443, 454-55 (quoting *Katz v. United States*, 389 U.S. 347, 357 (1967)).

65. 538 N.E.2d 961 (Ind. Ct. App. 1989).

making a U-turn before reaching a roadblock is a specific and articulable fact justifying a *Terry* stop.⁶⁶ In *Snyder*, a police officer pursued the defendant who made a U-turn approximately 100 yards from the roadblock, and eventually arrested him for driving while intoxicated.⁶⁷ The parties stipulated that the driver had committed no traffic violations, nor was he driving erratically.⁶⁸

Citing *State v. Garcia*,⁶⁹ the court determined that “inclusion of a no U-turn policy into the [roadblock] procedure further strengthens the degree to which the public interest is advanced”⁷⁰ and thus justifies the increased interference with an individual’s liberty. However, the court acknowledged this new rule will create problems in certain circumstances, and only upon a case-by-case basis can the court determine if the officer’s actions are reasonable.⁷¹

As an example of the type of difficulty this rule could pose, the court in *Snyder* stated:

[T]he rule does not allow for cases where drivers come within a ‘reasonable distance’ of the roadblock, but the driver’s conduct does not arouse a reasonable suspicion. For example, if the driver of an automobile drove within one hundred (100) yards of the roadblock and turned off onto another street, the officer would be entitled to stop the driver even if the driver’s home was located on the street.⁷²

In cases such as these, the court offered the following analysis to justify the stop: the avoidance of a roadblock by making a U-turn raises a “specific and articulable fact” which in turn gives rise to a reasonable suspicion on the part of an officer that the driver may be committing a crime, entitling the officer to detain a driver.⁷³

Snyder appears to be a result-oriented case. The majority’s attempt to distinguish between a U-turn and a turn-off is weak. In both situations, no crime nor infraction has been committed, and the officer is unaware of the driver’s reason for turning.

Furthermore, as Judge Conover emphasizes in his dissent, in Indiana investigatory stops are not permitted upon an officer’s suspicion alone.⁷⁴

66. *Id.* at 966.

67. *Id.*

68. *Id.*

69. 500 N.E.2d 158 (Ind. 1986).

70. *Snyder v. State*, 538 N.E.2d 961, 965-66 (Ind. Ct. App. 1989).

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.* at 967 (Conover, J., dissenting).

The dissent implied that this was another example of the court being swept away by the anti-drunk driving campaign, and symbolizes the current unspoken policy that the overriding concern in Indiana is to arrest drunk drivers, no matter what the costs. Judge Conover wrote:

If we are going to permit stops on no more than a police officer's hunch, we should forthrightly say a private citizen may not invoke the Fourth Amendment's protection whenever he drives an automobile because the danger to the public from drunk drivers transcends private constitutional rights. I find such an unqualified statement sobering and unwarranted to say the least. I would state to the contrary. We must do more than hum the Fourth Amendment's tune, we must loudly sing its lyrics at every available opportunity, if it is to survive in any meaningful form.⁷⁵

The United States Supreme Court has recently granted certiorari to review the constitutionality of roadblocks and other related issues.⁷⁶ In light of this, the long-term significance of *Snyder* may be undermined or strengthened.

In *Williams v. State*,⁷⁷ the Indiana Court of Appeals found a search warrant insufficient because the affidavit upon which it was based did not provide sufficient information from which the judge could determine that probable cause existed.⁷⁸ Specifically, the affidavit was defective because it was based upon an informant's tip which failed to provide a statement concerning how the informant knew the listed items were located at the named residence.⁷⁹

However, the court in *Williams* determined that the inadequacies in the affidavit were of form rather than substance, because testimony at the suppression hearing disclosed that the informant had actually seen some of the designated items at the residence.⁸⁰ The court found the *Leon*⁸¹ good-faith exception applied and thus the evidence seized was properly admitted.

75. *Id.* at 967-68.

76. Michigan Dep't of State Police v. Sitz, 88-1897, *argued*, February 27, 1990.

77. 528 N.E.2d 496 (Ind. Ct. App. 1988).

78. *Id.* at 499.

79. See *Illinois v. Gates*, 462 U.S. 213 (1983) for the law describing the requirements when an affidavit is based upon an informant's tip. In *Gates*, the United States Supreme Court stated that all the given circumstances must be set forth in the affidavit when based upon hearsay, including the "veracity" and "basis of knowledge" of the person supplying the hearsay information. *Id.* at 238.

80. *Williams*, 528 N.E.2d at 499.

81. *United States v. Leon*, 468 U.S. 897 (1984).

Dissenting, Judge Shields wrote that the affidavit was so unquestionably deficient that the presumption that the magistrate was detached and neutral was lost.⁸² "Otherwise stated, the warrant could have been issued only by a magistrate who had wholly abandoned his or her judicial role. For that reason, the good faith exception is unavailing."⁸³

Judge Shields' language in her dissent is unique because there are virtually no cases in the country which blame the magistrate for the failure to discern whether the affidavit is defective. In the seminal case of *United States v. Leon*,⁸⁴ which established the federal good-faith exception to the exclusionary rule,⁸⁵ Justice White, writing the majority opinion, opined that "the exclusionary rule is designed to deter police misconduct rather than to punish the errors of judges and magistrates."⁸⁶ But as Judge Shields emphasized, the exception does not apply when the judge or magistrate abandons his or her neutral role; and accordingly, the items seized should have been suppressed.⁸⁷ Of significance is the willingness of Judge Shields to dispose of a case on grounds not forcefully argued in virtually any case.

In *State v. Jorgensen*⁸⁸ and *State v. Pease*,⁸⁹ the Indiana Court of Appeals affirmed the order of the trial court suppressing illegally seized evidence. At issue in *Jorgensen* was the propriety of a four-hour warrantless search by officers who were called to the defendant's house to investigate a shooting.⁹⁰ Upon arrival, investigators discovered that the defendant's husband was shot dead. The officers told the defendant, Vonda, that they intended to search the residence, and she did not object.⁹¹ At no time did they ask Vonda's permission to search, and the resulting four-hour search resulted in the discovery of evidence which implicated Vonda in her husband's murder.⁹²

The issue before the court of appeals in *Jorgensen* was whether Vonda, by acquiescing to the search, had consented to the search. While recognizing that express consent is not a requirement for a valid consent search,⁹³ the court held that because all the facts indicated that Vonda

82. *Williams*, 528 N.E.2d at 501.

83. *Id.*

84. 468 U.S. 897 (1984).

85. The *Leon* good faith exception to the exclusionary rule was specifically adopted in Indiana in *Blalock v. State*, 483 N.E.2d 439 (Ind. 1985).

86. *Leon*, 468 U.S. at 916.

87. See *Lo-Ji Sales, Inc. v. New York*, 442 U.S. 319 (1979).

88. 526 N.E.2d 1004 (Ind. Ct. App. 1988).

89. 531 N.E.2d 1207 (Ind. Ct. App. 1988).

90. 526 N.E.2d at 1004.

91. *Id.* at 1005.

92. *Id.*

93. See *Harper v. State*, 474 N.E.2d 508, 512 (Ind. 1985).

in no way assisted the search, the State had failed to meet its burden of showing that Vonda had freely and voluntarily given her consent.⁹⁴ A failure to object to a suggested search is not equivalent to consent.⁹⁵

In *Pease*,⁹⁶ the Indiana Court of Appeals affirmed the decision of the trial court to suppress evidence seized when an officer improperly frisked the defendant, a driver of an automobile justifiably stopped for an equipment violation.⁹⁷ After stopping, the driver exited the automobile, at which time the officer frisked him and discovered amphetamines. In accordance with *Terry v. Ohio*,⁹⁸ the court held that because the officer had no particularized belief that the driver was armed and presently dangerous, the frisk amounted to an improper, generalized search.⁹⁹ The state argued on appeal that the frisk was justified as a search incident to a lawful arrest. The court correctly rejected this argument, noting that because Pease's arrest occurred after the frisk, it could not function as authority for the search.¹⁰⁰

III. DISCOVERY

Criminal discovery in Indiana and elsewhere is usually commenced when the defense receives a copy of the charging information or indictment, along with the supporting probable cause affidavit. These two documents alone inform the defense of critical facts, and the absence of material information in the charging document can be the basis of a dismissal.¹⁰¹

In *Locke v. State*,¹⁰² the Indiana Court of Appeals rejected the argument of the state that a defect in the charging information, here the absence of the victim's name, was cured by incorporating the accompanying probable cause affidavit and a copy of the victim's nineteen

94. *Jorgensen*, 526 N.E.2d at 1007.

95. Other mitigating factors are those that appear in *Harper v. State*, 474 N.E.2d 508 (Ind. 1985) (defendant's wife was present during the search and assisted an officer by finding paper bags in which to place seized items); *Lewis v. State*, 285 Md. 705, 404 A.2d 1073 (1979) (defendant left his house key with a neighbor for the purpose of giving the police access to his home for a search); *State v. Fredette*, 411 A.2d 65 (Me. 1979) (defendant returned to the house twice while the search was occurring and accompanied an officer with inventoried items).

96. *State v. Pease*, 531 N.E.2d 1207 (Ind. Ct. App. 1988).

97. *Id.* at 1212. The equipment violation was a badly cracked windshield.

98. 392 U.S. 1 (1968).

99. *Pease*, 531 N.E.2d at 1212.

100. *Id.*

101. See IND. CODE § 35-34-1-2 (1988), which sets forth the requisite contents of an information.

102. 530 N.E.2d 324 (Ind. Ct. App. 1988).

page statement.¹⁰³ In holding the trial court erred in denying the defendant's motion to dismiss, the court ruled that Indiana Code section 35-34-1-2, which sets forth the requisite contents of an information, does not contemplate incorporation by extraneous materials.¹⁰⁴ Accordingly, in Indiana a defective information cannot be cured by specifics contained in other material received through discovery.

Criminal discovery is undergoing a monumental revolution, due in part to advanced technological developments. DNA testing will have a great impact on current law regarding the availability of public funds to employ expert witnesses to conduct independent tests on behalf of indigent defendants. Recently, the Indiana Supreme Court rejected a defendant's appeal based upon the assertion that the trial court erred in refusing to furnish him with funds to employ expert witnesses.¹⁰⁵

In *Graham v. State*,¹⁰⁶ the defendant was accused of rape, criminal deviate conduct, and confinement.¹⁰⁷ At trial, the state produced two medical experts, both of whom performed various tests to determine the presence of sperm and the chemical makeup of body fluids taken from the victim.¹⁰⁸ The forensic scientist for the state testified that the samples taken from the victim's body "were consistent with what one would find in eighty percent of the population."¹⁰⁹

The Indiana Supreme Court reasoned that because the expert's testimony was "inconclusive," the trial court did not abuse its discretion in refusing to appoint an expert to examine the samples on behalf of the indigent defendant.¹¹⁰ Yet the determination of the court that the evidence was "inconclusive" is not supported by the record, nor is it logical. The trial below was a jury trial, and it was in the sole province of the jury to determine the weight to be given to the evidence. Simply because the reviewing court, which purports to abstain from weighing the evidence, decides for itself such evidence is inconclusive is not a valid reason for denying the defendant's request for the appointment of an expert.¹¹¹

103. *Id.* at 325.

104. *Id.*

105. *Graham v. State*, 535 N.E.2d 1174 (Ind. 1989).

106. 535 N.E.2d 1174 (Ind. 1989).

107. *Id.* at 1175. The defendant was ultimately convicted of rape and confinement.

108. *Id.* at 1175. Timothy Hagmaier, a medical technologist, testified that the tests he performed demonstrated the presence of a male enzyme. James Romack, a forensic serologist for the Indiana State Police, testified that his tests determined that the victim was a secretor. *Id.*

109. *Id.*

110. *Id.* at 1175-76.

111. It is impossible to hypothesize what weight the jury may have given expert testimony proffered by the defendant, nor even what the testimony may have been. The

The impact of DNA testing on cases such as *Graham* cannot be exaggerated. Because DNA evidence is supposedly foolproof and can demonstrate guilt or innocence, competent counsel will routinely ask for a private DNA test. It will be hard for the court to justify denial of funds for such tests. Thus, the cost of public defense will substantially increase in the very near future.

The preservation of evidentiary material which may be exculpatory is not required under the fundamental fairness requirement of the Due Process Clause, absent a showing of bad faith on the part of the police, according to a United States Supreme Court decision¹¹² recently applied in Indiana.¹¹³ In *Arizona v. Youngblood*,¹¹⁴ the Supreme Court refused to interpret the fundamental fairness requirement of the due process clause as imposing on the state¹¹⁵ an undifferentiated and absolute duty to retain and preserve all materials or evidence that might be of evidentiary significance so as to preserve the defendant's constitutionally guaranteed access to evidence in discovery.¹¹⁶ The Court stated that unless a criminal defendant can show bad faith on the part of the police, *i.e.*, the state, the failure to preserve potentially useful evidence does not constitute a denial of due process of law.¹¹⁷ In *Youngblood*, the Court determined that the officer's failure to refrigerate the victim's clothing and perform tests is merely negligence, as none of the information was concealed from the defendant, and the clothing and semen sample were made available to defendant's experts.¹¹⁸

Youngblood imposes on the defendant the burden of establishing bad faith on the part of the state, an almost insurmountable burden when the only evidence which would have a tendency to prove that fact either has been destroyed or is in the exclusive possession of the state and is nondiscoverable.

Applying *Youngblood*, the Indiana Supreme Court, in *Madison v. State*¹¹⁹ determined that no due process violation occurs with "the failure

defendant was denied a fair trial by forcing him to go to trial with the testimony of the state's expert witnesses solely. While the appointment of experts for indigent defendants is within the discretion of the trial court, the trial court has a duty to appoint experts except when such expense would be needless, wasteful or extravagant. For all practical purposes, *Graham* stands for the proposition that due process is afforded the indigent defendant only when the reviewing court determines *de novo* that the state's evidence is "inconclusive."

112. *Arizona v. Youngblood*, 109 S. Ct. 333 (1988).

113. *Madison v. State*, 534 N.E.2d 702 (Ind. 1989).

114. 109 S. Ct. 333 (1988).

115. The term "state" in this case means the arm of the state, *i.e.*, the police.

116. *Youngblood*, 109 S. Ct. at 337.

117. *Id.*

118. *Id.*

119. 534 N.E.2d 702 (Ind. 1989).

of the state to preserve evidentiary material of which no more can be said than that it could have been subjected to tests, the results of which might have exonerated the defendant," provided the defense makes no showing of bad faith on the part of the police.¹²⁰ In *Madison*, the court reasoned that because the evidence would not have been exculpatory,¹²¹ its omission had no prejudicial impact on the defendant.¹²²

A cursory glance at *Madison* would seem to indicate that the court determined that the burden of establishing prejudice in the omission of exculpatory evidence because it was not preserved by the state rests with the defendant. Yet any language in the opinion to support such a conclusion is dicta; the court did not have to reach the question of how the burdens should be parcelled out in a destruction of evidence case.¹²³ The court avoided deciding that issue by holding that the evidence was in fact not exculpatory.

In a concurring opinion, Justice DeBruler in *Madison* suggested that "once the defendant shows that the government has destroyed evidence of an exculpatory nature, the burden should be upon the government to establish the absence of prejudice."¹²⁴ Furthermore, as Justice Blackmun reasoned in his dissenting opinion in *Youngblood*, placing the burden on the defendant to show bad faith is fundamentally inconsistent with the defendant's constitutional guarantee to a fair trial.¹²⁵

IV. CONFESSIONS AND ADMISSIONS

Two critical Indiana cases concerning the voluntariness of confessions were decided in the survey period. Unfortunately, both ignore practical realities, and are sure to lead to an increasingly frustrated criminal bar. Following on the heels of these two cases is a United States Supreme

120. *Id.* at 707 (quoting *Arizona v. Youngblood*, 109 S. Ct. 333, 342 (1988)).

121. The court determined the omitted evidence would not have been exculpatory on the facts of the case. *Madison* involved a stabbing, in which one of the knives found on the scene of the crime was not dusted for fingerprints, and the defendant was claiming self-defense. 534 N.E.2d at 706-07. The court stated that "evidence of [the deceased] fingerprints on the knife would not have been exculpatory to appellant because it was established at trial that the knife belonged to [the deceased]." *Id.* at 707.

122. *Id.*

123. See *Johnson v. State*, 507 N.E.2d 980 (Ind. 1987), where the same issue was left unresolved because of an evenly divided court.

124. 534 N.E.2d at 707.

125. *Arizona v. Youngblood*, 109 S. Ct. 333, 345 (1988). Additionally, Justice Blackmun criticized the majority for its reliance on the good faith/bad faith test stating that there is no bright-line test for determining good faith or bad faith, and placing the burden on the defendant to demonstrate bad faith essentially creates an unsurmountable burden. *Id.* at 342 (Blackmun, J., dissenting).

Court case which, when combined with the Indiana cases, is particularly problematic given the uncertain application of the law.

In *Duckworth v. Egan*,¹²⁶ the United States Supreme Court legitimized a variation of the traditional *Miranda* warning.¹²⁷ At issue was the propriety of the following words: "You have the right to remain silent. Anything you say can be used against you in court. You have a right to talk to a lawyer for advice before we ask you any questions, and to have him with you during questioning. You have this right to the advice and presence of a lawyer even if you cannot afford to hire one. *We have no way of giving you a lawyer, but one will be appointed for you, if you wish, if and when you go to court.*"¹²⁸ In an opinion destined to create chaos, the Court determined that the italicized language did not render the *Miranda* warning of right to counsel inadequate.¹²⁹ Rather, the Court reasoned that the language merely answers the anticipated question of when counsel is appointed and neither suggests that only those persons who can afford an attorney have the right to have one present before answering any questions nor that if the accused does not go to court he is not entitled to counsel at all.¹³⁰

The legitimization of *Miranda* deviations will undoubtedly lead to an increase in litigation. The more liberties police officers take in designing the warning, the more liberties will be lost by defendants, many of whom do not understand traditional *Miranda* warnings. This will create a plethora of defendants waiving rights without making a truly informed consent to do so.¹³¹ Inevitably, more and more people will be convicted on the basis of statements made involuntarily, in that they were not made after an intelligent waiver of the right to remain silent or to have an attorney present.

Usually, the invocation of the right to an attorney bars all further questioning, or at least is grounds for suppression. Yet recently the

126. 109 S. Ct. 2875 (1989).

127. *Id.*

128. *Id.* at 2877 (emphasis in original).

129. *Id.* at 2880.

130. *Id.*

131. *Martin v. State*, 537 N.E.2d 491 (Ind. 1989) applied the rule announced the prior year in *Chase v. State*, 528 N.E.2d 784 (Ind. 1988), that statements made to an officer concerning a possible plea bargain are admissible and are not privileged communications relating to the plea bargaining process, when certain conditions are met. See *infra* notes 139-42 and accompanying text. In *Martin*, the defendant satisfied the first prong of the *Chase* test in that he had been charged when he made statements offering a bargain, but the second prong was not satisfied as the officer contacted did not have authority to bargain on behalf of the state, nor did he purport to have such authority. Even though the officer asked some preliminary questions, there was no reason to believe he was in a position to bargain. 537 N.E.2d at 493-94.

Indiana Supreme Court determined in *Lord v. State*¹³² that because the defendant had made a full confession before inquiring about a lawyer, and because the content of the subsequent statement did not contradict or add anything to the prior statement, no reversible error occurred.¹³³

In *Lord*, the defendant voluntarily went to the police to speak with them concerning the death of an acquaintance.¹³⁴ The defendant claimed his subsequent confession was involuntary, as the product of coercion, because the interrogating officer proposed that if the defendant would talk they would promise that a deal would be cut with the prosecuting attorney.¹³⁵ The officers stated "If I could promise you . . . if I could promise you . . . if I could promise you he'd [the prosecutor] cut a deal with you, would you then talk and tell the truth?"¹³⁶ This was followed by a statement by the officer "[I]f I can get him down here, would you tell the truth, if he'd cut you a deal?"¹³⁷

The Indiana Supreme Court rejected the defendant's argument that the officer's statements induced him into making incriminating statements because of his improper promises. The court determined that the officer was merely asking "what if" questions, and as such did not constitute improper promises.¹³⁸ The decision of the court ignores reality; police make these statements to suspects for the purpose of inducing them to make incriminating statements. When the entire context of the conversation is examined, it becomes clear that the investigating officer in fact induced the defendant to make statements by his promise to try to cut a deal for him. However vague the officer's words may have been, it does not matter, because in fact it produced the desired result - the defendant confessed.

It has long been recognized that communications relating to plea bargains are privileged.¹³⁹ Yet the scope of this privilege has been seriously maligned in *Chase v. State*.¹⁴⁰ In *Chase*, the Indiana Supreme Court held that statements made by a defendant to a police officer prior to the existence of any charge against him, and made to one without authority to enter into a binding plea agreement are not privileged and therefore are admissible.¹⁴¹ The court reasoned that such statements are

132. 531 N.E.2d 207 (Ind. 1988).

133. *Id.* at 209.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. See IND. CODE § 35-35-3-4 (1988).

140. 528 N.E.2d 784 (Ind. 1988).

141. *Id.* at 786.

not part of the plea bargaining process pursuant to Indiana Code section 35-35-3-4, and hence do not fall within the rule that statements which are part of plea bargaining process are inadmissible at a subsequent trial.¹⁴²

Especially troubling in *Chase* is the court's myopic idealism of real world considerations. The court stated that "the plea bargaining process does not start until persons having the authority to make a binding agreement have agreed to negotiate."¹⁴³ However, those inexperienced individuals unfortunate enough to be confronted by a police officer in connection with a criminal investigation do not know that police do not have authority to enter into plea agreements. Worse, many police use their apparent authority to coerce from individuals incriminating statements. Compounding the problem is the fact that many prosecutors will not enter into plea negotiations if the arresting officer protests strongly. This means that in the course of an investigation, officers are free to set mental traps, designed to catch unwary individuals making incriminating statements.

V. TRIAL PROCEDURE

Three recent cases address issues which arise in jury trials.¹⁴⁴ In *Minniefield v. State*,¹⁴⁵ the Indiana Supreme Court expanded its interpretation of *Batson v. Kentucky*,¹⁴⁶ and held that it was error for the trial court to deny the defendant's motion for a mistrial on the basis of the purposeful exclusion of black jurors.¹⁴⁷

In *Minniefield*, the prosecutor exercised six peremptory challenges to strike one white and five black members of the panel, leaving only one black person on the jury panel of twelve.¹⁴⁸ The defendant moved for a mistrial. The prosecutor responded that his reasons for striking the black jurors would become apparent at trial.¹⁴⁹ The court reserved

142. *Id.*

143. *Id.*

144. Recently the Indiana Court of Appeals ruled that in a bench trial, the proper motion for judgment at the close of the state's case is not a Trial Rule 50 motion for judgment on the evidence, but rather a Trial Rule 41(B) motion for involuntary dismissal. *State v. Vowels*, 535 N.E.2d 146 (Ind. Ct. App. 1989). In *Vowels*, the court held that the trial court may weigh evidence and judge the credibility of the witnesses, and the establishment of a prima facie case by the state does not require the trial court to find for the state. *Id.* at 147. See also *State v. Mayfield*, 536 N.E.2d 294 (Ind. Ct. App. 1989).

145. 539 N.E.2d 464 (Ind. 1989).

146. 476 U.S. 79 (1986).

147. *Minniefield*, 539 N.E.2d at 465.

148. *Id.*

149. *Id.*

judgment on the motion, and at the close of evidence, the defendant renewed his motion for a mistrial.¹⁵⁰

In response, the prosecutor stated that he had struck the jurors for "strategic purposes" because he feared the black jurors would take offense at the racist jokes attributed to the victim.¹⁵¹ The trial court denied the motion for mistrial, and the defendant contended this constituted reversible error.

In determining whether it was error for the state to use its peremptory challenges to strike members of a race, the court in *Minniefield* reviewed the recent Supreme Court decision which established a three-prong test for determining a violation of equal protection claims in jury selection. In *Batson v. Kentucky*,¹⁵² the Court held that a race-based equal protection violation in jury selection may be established solely from the state's exercise of peremptory challenges.¹⁵³ Once the defendant demonstrates that he is a member of a cognizable race and that the state has used its peremptory challenges to strike members of his race, an inference of purposeful discrimination arises and the burden shifts to the prosecutor to come forward with a neutral explanation.¹⁵⁴

The Indiana court in *Minniefield* applied *Batson* and determined that a "neutral" explanation does not mean "justifiable on strategic grounds."¹⁵⁵ Rather, it means "neutral with regard to the struck juror's group identity" - here, race.¹⁵⁶ The court found that the trial court erred when it failed to grant the defendant's request for a mistrial on the basis of the state's "grossly disparate use of its challenges."¹⁵⁷ In the end, the prosecutor's excuse for its use of peremptory challenges was race-based and therefore violated the defendant's equal protection rights.

150. *Id.*

151. *Id.* During the robbery, two pieces of paper fell out of the victim's pants. Printed on both were racist jokes, one targeting blacks, and the other targeting Hispanics. *Id.*

152. 476 U.S. 79 (1986).

153. *Id.* The *Batson* test is as follows:

To [establish a denial of equal protection] the defendant must show: (1) he is a member of a cognizable racial group; (2) the prosecutor has peremptorily challenged members of the defendant's race; and (3) these facts and other relevant circumstances raise an inference that the prosecutor used that practice to exclude veniremen from the petit jury because of their race. By showing these three factors the defendant raises an inference of purposeful discrimination which requires the State to come forward with a neutral explanation for challenging the veniremen; the explanation need not rise to the level required to justify a challenge for cause. *Id.* at 96.

154. *Id.*

155. 539 N.E.2d at 466.

156. *Id.*

157. *Id.*

In *Hicks v. State*,¹⁵⁸ the Indiana Supreme Court adhered to its earlier ruling in *Hatchett v. State*,¹⁵⁹ that sharing by co-defendants of peremptory challenges as a consequence of joinder can make joinder an abuse of discretion if "actual prejudice" can be shown.¹⁶⁰ In *Hicks*, the defendant failed to show actual prejudice, as the defendant failed to state how he was harmed by the presence of any particular juror on the panel, nor did he present a transcript of *voir dire* in the record.¹⁶¹ Hence, *Hicks* represents the continuing caution of the court, although dicta, that forcing defendants to join can be harmful in jury trials, leaving the door open for reversal if the defendant can show harm.

The final significant case in this survey period which concerns jury trials in criminal causes is *Mareska v. State*.¹⁶² In a case of first impression, the Indiana Court of Appeals held that the sixth amendment to the United States Constitution is violated in a trial for a misdemeanor committed outside the city limits where the jury is composed entirely of qualified voters from within the city.¹⁶³

In *Mareska*, the defendant was charged with disorderly conduct for an incident which occurred in Starke County, Indiana.¹⁶⁴ The charging affidavit was filed in the Knox City Court.¹⁶⁵ The city court denied the defendant's motion to dismiss for lack of jurisdiction, and a jury found the defendant guilty.¹⁶⁶ *Mareska* appealed the city court conviction, and a *de novo* trial before the Starke Circuit Court similarly resulted in conviction.¹⁶⁷

While the court found that this improperly paneled jury violated *Mareska*'s sixth amendment rights to an impartial jury drawn from the district where the alleged crime was committed,¹⁶⁸ no remedy was required as the defendant subsequently received a fair trial before the circuit court jury selected from the county where the alleged crime occurred.¹⁶⁹

158. 536 N.E.2d 496 (Ind. 1989).

159. 503 N.E.2d 398 (Ind. 1987).

160. 536 N.E.2d at 499.

161. *Id.*

162. 534 N.E.2d 246 (Ind. Ct. App. 1989).

163. *Id.* at 250.

164. *Id.* at 247.

165. *Id.*

166. Throughout the city court proceedings, the defendant refused to personally appear in court, maintaining his jurisdictional objection. *Id.*

167. *Id.* at 248.

168. The relevant part of the sixth amendment reads "In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the state and district wherein the crime shall have been committed. . . ." U.S. CONST. amend. VI.

169. 534 N.E.2d at 250.

It is significant that the court is willing to reach the constitutional issue. Generally, reviewing courts will not decide a constitutional issue if the case can be resolved by other means. Nonetheless, the court reasoned that because this was a "classic case of an error that is 'capable of repetition, yet evading review,'"¹⁷⁰ the merits of the constitutional issue necessitated a resolution.

Often upon review of a decision of a trial court, the appellate court finds error, but determines the appellant's failure to demonstrate prejudice renders the error harmless. This was precisely the situation in *Diggs v. State*,¹⁷¹ where the Indiana Supreme Court found harmless the suppression of a defense witness' testimony and the subsequent refusal by the trial court to admit the witness' deposition.¹⁷²

In *Diggs*, at the close of the state's evidence and prior to the defendant's presentation of evidence, the prosecutor informed a defense witness that if he testified to "the same statements he did in his deposition, he [would] be charged, according to his own testimony."¹⁷³ The witness subsequently refused to testify when called as a witness on behalf of the defense, invoking the fifth amendment.¹⁷⁴ The trial court denied the defendant's request to admit the witness' deposition into evidence upon the state's objection that the defendant was not unavailable.¹⁷⁵

On appeal, the defendant claimed that the prosecutor's action amounted to misconduct and that the trial court erred in refusing to admit the witness' deposition.¹⁷⁶ The court agreed, finding that the prosecutor by such conduct had improperly denied the defendant the use of the witness' testimony regardless of his good intentions.¹⁷⁷ The court stated that a prosecutor may not prevent or discourage a defense witness from testifying.¹⁷⁸ Once the witness has invoked his privilege against self-incrimination, the court committed error by refusing defense counsel's request to use the witness' deposition.¹⁷⁹

While the defendant's right to call witnesses on his own behalf was violated by the prosecutor's misconduct, the court determined that such error was harmless, because the defendant failed to make a plausible showing that the improperly suppressed testimony would have been

170. *Id.* (citing *Ray v. State Election Bd.*, 422 N.E.2d 714 (Ind. Ct. App. 1981)).

171. 531 N.E.2d 461 (Ind. 1988).

172. *Id.* at 464.

173. *Id.* This conversation took place in the corridor outside the courtroom. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* Depositions are admissible if the deponent invokes his fifth amendment privilege to remain silent when called as a witness. *Id.*

materially favorable to his defense, and not merely cumulative.¹⁸⁰

VI. POST-TRIAL PROCEDURE: THE DEATH PENALTY CASES

In the last year, the Indiana Supreme Court decided two death penalty cases of exceptional importance. The conflict presented by these two cases, both between the cases and with past decisions of the Indiana Supreme Court, demonstrates the failure of the court to develop a cohesive jurisprudential attitude toward imposition of the death penalty. These cases represent the *ad hoc* nature of the court's decision-making process in capital cases. Ultimately, the conflicts between these cases, and with prior cases, leave in doubt the very issues that the court has purportedly decided, thereby providing little guidance to the bench and bar.

In *Martinez Chavez v. State*,¹⁸¹ the Indiana Supreme Court appeared to enunciate the standard against which judicial override of jury verdicts recommending a sentence other than death would be measured.¹⁸² Specifically, the court held that in order to sentence a defendant to death after the jury has recommended against death, "the facts justifying a death sentence should be so clear and convincing that virtually no reasonable person could disagree that death was appropriate in light of the *offender and his crime*."¹⁸³ The court claimed that it held that a trial court cannot override the recommendation of the jury unless the facts meet this standard.¹⁸⁴

In *Chavez*, the defendant had been tried jointly with a co-defendant by the name of Rondon.¹⁸⁵ The court concluded that Rondon was the leading personality in the crime.¹⁸⁶ Given the difference of the weight of the evidence between the two defendants, and apparently, different personal characteristics, the court concluded that the trial judge had not met the requisite standard.¹⁸⁷

The decision in *Chavez* seemed to indicate a reluctance on the part of the court to allow judicial overrides. Yet, a mere six months later, the court appeared to retreat from its holding in *Chavez* in *Minnick v. State*¹⁸⁸.

180. *Id.* at 464.

181. 534 N.E.2d 731 (Ind.), *reh'g denied*, 539 N.E.2d 4 (Ind. 1989).

182. *Id.*

183. *Id.* at 735 (emphasis added).

184. *Id.*

185. *Id.* at 732.

186. *Id.* at 735.

187. *Id.*

188. 544 N.E.2d 471 (Ind. 1989).

In *Minnick*, the defendant was charged with the offenses of murder, rape, and robbery.¹⁸⁹ A prior jury trial in 1982 resulted in the conviction and sentence of death.¹⁹⁰ The death sentence was reversed and remanded by the Indiana Supreme Court.¹⁹¹ On remand, the defendant was again found guilty and sentenced to death.¹⁹² On the subsequent appeal, the Indiana Supreme Court this time affirmed the death sentence.¹⁹³

While there are many troubling aspects to the *Minnick* decision,¹⁹⁴ the most troubling is the fact that the court sustained the decision of the trial court to override the jury's recommendation against death.¹⁹⁵ In so doing, the court, as a practical matter, eviscerated the standard formulated in *Chavez*.

The trial court in *Minnick* found as an aggravating factor justifying a death sentence, the fact that the murder occurred while the defendant was committing the offenses of rape and robbery.¹⁹⁶ The court further found aggravating circumstances in that the decedent was apparently mutilated and violated after death.¹⁹⁷

The Indiana Supreme Court, sustaining the trial court's override of the jury verdict, focused only on the defendant's crime. The court in its entire treatment of the appropriateness of the death penalty for this defendant, states:

In the instance case, however, the evidence at trial revealed that appellant shares his culpability with no one. He alone bears criminal responsibility for this singularly brutal homicide in the course of which the victim was raped, sodomized, stabbed, bludgeoned, strangled, and electrocuted. *In light of these circumstances*, it seems fair to state that no reasonable person would find a death sentence inappropriate here.¹⁹⁸

It is obvious that the court failed entirely to consider the circumstances surrounding the offender and his life. Thus, the court does not appear to follow its own standard in *Chavez*. Further, it seems to repudiate the many decisions in which the court has stated that the

189. *Id.*

190. *Id.* at 473.

191. *Minnick v. State*, 467 N.E.2d 754 (Ind. 1984), *cert. denied*, *Indiana v. Minnick*, 472 U.S. 1032 (1985).

192. *Minnick v. State*, 544 N.E.2d 471 (Ind. 1989).

193. *Id.*

194. Among the troubling factors in *Minnick* is the fact that evidence pointing to Minnick's innocence was apparently minimized by both the trial and Supreme Court.

195. *Id.* at 482.

196. *Id.* at 481.

197. *Id.*

198. *Id.* at 482 (emphasis added).

circumstances of the offender's life will be considered in the court's independent review of the appropriateness of the death penalty.¹⁹⁹

It is thus unclear whether there is an effective standard governing the circumstances under which a trial court might override a jury verdict. It appears the trial courts are free to override the jury verdict and, if the facts of the crime alone are particularly outrageous, the court may assume that the conviction will be affirmed by the Indiana Supreme Court.

199. The Indiana Supreme Court has sent mixed signals when "reviewing" the appropriateness of the death penalty. In many cases, the review is so brief that the only logical conclusion is that the court was focusing only upon the crime. *See, e.g.*, *Games v. State*, 535 N.E.2d 530 (Ind. 1989). In other cases, the court does seem to independently consider the facts and the offender. *See, e.g.*, *Cooper v. State*, 540 N.E.2d 1216 (Ind. 1989). In a third line of cases, the court adopts a sufficiency of the evidence standard. *See, e.g.*, *Moore v. State*, 469 N.E.2d 1264 (Ind. 1985); *Vandiver v. State*, 480 N.E.2d 910 (Ind. 1985). However, in many cases there is no discussion of the appropriateness of the penalty. *See Smith v. State*, 465 N.E.2d 1105 (Ind. 1984); *Canaan v. State*, 541 N.E.2d 894 (Ind. 1989).

Indiana Environmental Law: An Examination of 1989 Legislation†

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I. INTRODUCTION

The 1989 session of the Indiana General Assembly has been called "The Year of the Environment."¹ That appears to be an apt label. More environmental legislation was enacted in 1989 than in any year

† The 1990 Indiana General Assembly passed a number of significant environmental bills which, due to time constraints imposed by the publication date of this article, cannot be analyzed in detail here. The authors have attempted to footnote important changes made during the 1990 session to legislation discussed in this article; however, indepth discussion of the other 1990 legislation must be deferred until a later issue.

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1. Newland, *House Republicans to Back Death Penalty in Drug Killings*, Indianapolis Star, Jan. 5, 1989, at A-8, col. 1 ("[P]erhaps the most important issue we will address in the next four to five years [is the environment]. If we fail to provide long-term solutions to such critical problems as leaking underground storage tanks, the proper disposal of hazardous waste and the reduction of solid waste, we will seriously jeopardize the quality of life on this planet, not only for our children, but for our children's children." Quoting Indiana House of Representatives Co-Speaker Paul Mannweiler.)

"After years of introducing environmental protection bills that drew skepticism and sometimes outright ridicule from other legislators, State Sen. Vi Simpson finds herself being treated differently this year." Indianapolis Star, Dec. 31, 1988, at A-1, col. 1.

in recent memory.² This legislative activity comes on the heels of three national studies ranking Indiana among the least effective states in environmental protection.³

This increased legislative attention to the environment comes during a time when environmental issues are being considered nationally⁴ and

2. In 1983 and 1984, approximately two percent of the Public Laws passed by the Indiana General Assembly during its annual sessions could be said to have been laws that affected the environment in some way. In 1985 and 1986, this percentage increased slightly to approximately two and one-half percent. In 1987 and 1988, the percentage continued to increase to approximately three and one-half percent to three and three quarters percent. In 1989, the percentage of environmental laws passed by the Indiana General Assembly increased to almost six percent.

APPROXIMATE NUMBER OF PUBLIC LAWS "AFFECTING THE ENVIRONMENT" PASSED BY THE INDIANA GENERAL ASSEMBLY FROM 1982 THROUGH 1989

YEAR	NUMBER OF ENVIRONMENTAL LAWS	TOTAL NUMBER OF PUBLIC LAWS	PERCENT OF PUBLIC LAWS AFFECTING THE ENVIRONMENT
1982	5	232	2.2%
*1983	7	384	1.8%
1984	4	220	1.8%
*1985	10	375	2.7%
1986	6	251	2.4%
*1987	15	396	3.8%
1988	7	210	3.3%
*1989	21	357	5.9%

* The Indiana General Assembly holds a "long session," consisting of sixty legislative days, and a "short session," consisting of thirty legislative days in alternating years. Those years marked by an asterisk were long sessions; other years were short sessions.

3. See FUND FOR RENEWABLE ENERGY AND THE ENVIRONMENT, STATE OF THE STATES 1987, 1988 and 1989 Reports. These reports may be obtained from Fund for Renewable Energy and the Environment, 1001 Connecticut Avenue, N.W., Suite 719, Washington, D.C. The 1987 report showed Indiana tied for 13th with Maine in studies of air pollution reduction, soil conservation, groundwater protection, hazardous waste management, solid waste and recycling, and renewable energy and conservation. Indiana was one of six states found to have the best renewable energy and conservation policies. It should be noted, however, that Indiana's renewable energy tax credit, which was largely responsible for the high ranking, expired January 1, 1988. P.L. 1984-43, § 8. In 1988, Indiana was ranked 29th in surface water protection, reducing pesticide contamination, land use planning, eliminating indoor pollution, highway safety and energy pollution control. In 1989 Indiana was in 41st place in forest management, solid waste recycling, drinking water, food safety, and growth and the environment.

4. See, e.g., Sancton, *Planet of the Year, What on Earth Are We Doing?*, TIME, Jan. 2, 1989, at 24 ("Time analyzes the looming ecological crisis and provides an agenda for urgent action"); *Managing Planet Earth*, Special Issue, 261 Sci. AM. (Sept., 1989); *As We Begin Our Second Century, The Geographic Asks: Can Man Save This Fragile*

internationally⁵ as among the foremost issues of our time. Because of this increased legislative activity and increased environmental concern, this review of environmental laws passed by the 1989 General Assembly was undertaken. First, however, the authors provide an overview of Indiana's administrative structure for environmental protection.⁶ The new legislation cannot be understood in isolation. It will be implemented within the existing administrative system.

II. ADMINISTRATION OF INDIANA'S ENVIRONMENTAL LAWS

A. Introduction

The Indiana agency⁷ charged with administering what are commonly thought of as the "environmental laws"⁸ of the state is the Indiana Department of Environmental Management ("IDEM"). Created by the 1985 Indiana General Assembly,⁹ IDEM came into existence on April

Earth?, 174 NAT'L GEOGRAPHIC 766-914 (1989); Easterbrook, *Cleaning Up Our Mess: What Works, What Doesn't and What We Must Do To Reclaim our Air, Land and Water*, NEWSWEEK, July 24, 1989, at 26. As anyone who has surveyed recent popular magazines and newspapers knows, the preceding citations are only a small representation of the media's deluge of coverage of the issue of the environment in 1989.

5. "Apart from the fear of nuclear war, easily the most unifying force around the world is the desire of 9 in 10 people polled in 16 countries to take stronger action nationally and internationally to curb pollution and to reverse the serious decay of the environment. Over 2 in 3 feel their own health is endangered by environmental damage right in their own country." *Morning Edition* (National Public Radio broadcast by pollster Lou Harris) (Aug. 22, 1989).

6. See *infra* notes 8-42 and accompanying text.

7. The state of Indiana has been authorized by the United States Environmental Protection Agency ("EPA") to act as the primary enforcer of the most important federal environmental laws. *See, e.g.*, Clean Air Act State Implementation Plan Conditional Approval, 40 C.F.R. 52.773 (1989), amended by 53 Fed. Reg. 33,808, 38,719, 46,608, 50,521 (1988), and 54 Fed. Reg. 2,112, 33,894 (1989). This primary enforcement authority, or "primacy," allows Indiana to receive federal funds to implement the federal program in Indiana. Primacy also obliges the state to implement and enforce a regulatory program that is equivalent to and consistent with the federal program. *See, e.g.*, 42 U.S.C. § 6926(b) (1982). If a state with primacy fails to implement an adequate program, the EPA administrator is required to withdraw the state program and replace it with a federal program. Even in states with primary enforcement authority, the EPA maintains concurrent authority to enforce the federal statutes. *See, e.g.*, 42 U.S.C. § 6928 (Supp. V 1987).

8. IDEM implements regulatory programs to protect the air, land, and water of the state from harmful pollutants. Other laws, equally important for the protection of Indiana's environment, regulate the use of Indiana's natural resources and are administered by the Indiana Department of Natural Resources (IDNR). *See* IND. CODE §§ 13-2, 13-3, 13-4, 13-4.1, 14-2, 14-4, 14-5 (1988).

9. IDEM was created by a reorganization of the state environmental programs, and took responsibility for the day-to-day enforcement and implementation of the state's

1, 1986.¹⁰ IDEM was intended to be a separate state agency devoted entirely to the protection of the environment.¹¹ The Indiana General Assembly recognized that "the problem of pollution in our modern society is serious and complex, and can be adequately addressed at the state level only through an arm of state government provided with adequate funding, staff, and other resources."¹²

Programs built into the regulatory structure of IDEM¹³ include the water pollution control division,¹⁴ the air pollution control division,¹⁵ and the solid and hazardous waste management division.¹⁶ Each of these divisions regulates its respective "media" (that is, the water, the air, or the land) through a system of permits¹⁷ and rules¹⁸ that define the limits of environmentally acceptable behavior in the state.

environmental programs. 1985 Ind. Acts 1129. These programs had previously been implemented and enforced by the State Board of Health under the direction and authority of the Environmental Management Board, the Stream Pollution Control Board, and the Air Pollution Control Board. Those preexisting boards maintained their rule-promulgation and policy-making authority, but their names were changed to the Water Pollution Control Board, the Air Pollution Control Board, and the Solid Waste Management Board. *See* 1943 Ind. Acts 625; 1961 Ind. Acts 382; 1972 Ind. Acts 555, and 1985 Ind. Acts 1193.

10. 1986 Ind. Acts 1092.

11. *See* 1985 Ind. Acts 1074 (preamble).

12. One might question the legislature's commitment to "adequately address" this "serious and complex problem of pollution," given the perceived deficiencies in IDEM resources.

13. IND. CODE § 13-7-2-13 (1988) establishes not only the regulatory programs for air, water, and land, but also the office of environmental response for responding to environmental emergencies, the office of external affairs for communicating with the public, the office of hearings, the office of technical assistance to assist municipalities and small business and industry in their efforts to comply and to promote waste reduction and recycling; as well as offices of investigations, laboratory analysis, and administrative services.

14. Under IND. CODE § 13-7-2-15 (1988), the Water Pollution Control Division is the water pollution agency for the purposes of the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1387 (Supp. V 1987), and the Federal Safe Drinking Water Act (SDWA), 42 U.S.C. §§ 300f-300j (1984), except for the Underground Injection Control Program of the SDWA which is to be implemented by the Indiana Department of Natural Resource's Oil and Gas Division under IND. CODE ANN. §§ 13-8-1-1 to -15-7 (Burns Supp. 1989).

15. The Air Pollution Control Division has primacy for purposes of the Federal Clean Air Act, 42 U.S.C. §§ 7401-7642 (Supp. V 1987).

16. IND. CODE § 13-7-2-15 (1988) makes the solid waste management division the state agency for the purposes of the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6991 (Supp. V 1987).

17. *See* IND. CODE ANN. §§ 13-7-10-1 to -5 (Burns Supp. 1989); IND. ADMIN. CODE tit. 329, r. 3-33-54, 3-33-54 (Supp. 1989); IND. ADMIN. CODE tit. 329, r. 2-5-8 (1988); IND. ADMIN. CODE tit. 326, r. 2 (1988); IND. ADMIN. CODE tit. 327, r. 2-4 (1988).

18. These rules, codified in Titles 326, 327 and 329 of the Indiana Administrative Code, are promulgated by the respective boards under the authority of IND. CODE ANN.

While the structure of Indiana's Department of Environmental Management is basically sound, the agency has been found to lack the resources, staff, expertise, and aggressive enforcement to fully effectuate some of the legislative enactments.¹⁹ The report of the 1988 Legislative Sunset Committee regarding IDEM noted that "[n]ew areas of toxics and groundwater increase the complexity of an already complex field. *DEM resources are being spread thin.*"²⁰ A study conducted by the Council of State Governments shows Indiana ranked near the bottom in two important measures of state expenditures on environmental programs. Indiana was 49th in per capita spending, and 47th in expenditures as a percentage of the total state budget.²¹

B. Enforcement

Behavior that exceeds limits of environmental acceptability can, theoretically, result in one or more of three types of enforcement actions: an action initiated by the commissioner of IDEM, an emergency action, or a citizen initiated action.²²

1. *IDE� Enforcement.*—The first, and by far the most common, enforcement action is one initiated by the commissioner of IDEM. The commissioner institutes an enforcement action by notifying the alleged violator in writing that a violation may exist and offering the alleged violator the opportunity to enter into an agreed order.²³ If the alleged

§§ 13-1-12-8, 13-1-3-4, and 13-1-1-3 (Burns Supp. 1989). The rules prohibit certain sources of pollutants from operating without a permit or from exceeding their permit limits. The rules also forbid everyone from undertaking certain pollution-causing activities, such as open burning. *See IND. ADMIN. CODE tit. 326, r. 4* (1988).

19. INDIANA LEGISLATIVE SERVICES AGENCY, SUNSET AUDIT OF THE DEPARTMENT OF ENVIRONMENTAL MANAGEMENT AND RELATED BOARDS, REPORT TO INDIANA LEGISLATIVE COUNCIL 16-17 (1988).

20. *Id.* (Executive Overview) (emphasis added).

21. *See R. BROWN & L. GARNER, RESOURCE GUIDE TO STATE ENVIRONMENTAL MANAGEMENT* (1988). This low level of spending for environmental programs comes at a time when Indiana state government has a general fund surplus of \$559.6 million and a Rainy Day Fund of \$265.4 million for the 1988-89 fiscal year. Interview with William J. Sheldrake, Director Tax & Revenue Policy for State of Indiana in Indianapolis, Indiana, August 31, 1989.

22. Although all three types of action are statutorily authorized, only the first option—action initiated by the commissioner in non-emergency situations—is used with any regularity.

23. This notice of violation must identify the actions required to correct the violation and, if appropriate, a civil penalty. The Commissioner is not required to extend this offer for more than sixty (60) days, and the alleged violator may enter into the agreed order without admitting that the violation occurred. IND. CODE ANN. § 13-7-11-2(b) (Burns Supp. 1989).

violator does not agree to an order within sixty days,²⁴ the commissioner may issue a unilateral order requiring that a specific action be taken, a civil penalty be paid, or both.²⁵ The unilateral order of the commissioner takes effect twenty days²⁶ after the alleged violator receives it, unless the alleged violator files a written request for review of the order with the commissioner before the twentieth day.²⁷ If a request for review is timely filed, the commissioner must appoint an administrative law judge (ALJ) to conduct the review proceedings on behalf of the appropriate board and in accordance²⁸ with the Administrative Orders and Procedures Act (AOPA).²⁹

2. *Emergency Enforcement.*—If an emergency³⁰ exists, the commissioner may bring an action in the name of the state to restrain any person from causing or contributing to the pollution that is causing the emergency.³¹ In addition to seeking injunctive relief in emergency situations, the commissioner may provide assistance to prevent, control, or neutralize any contaminant causing the emergency, and recover the cost

24. Because the Commissioner may not impose a unilateral order upon a violator until 60 days have passed from the time of the Notice of Violation, a recalcitrant violator may avoid the inevitable order (and continue its violation) for two months with no justification and without entering into good faith negotiations with IDEM. The required 60-day wait thus builds an unnecessary delay of up to two months into the administrative enforcement system. *Id.*

25. *Id.* § 13-7-11-2(c) (Burns Supp. 1989). This subsection also requires that the order: be sent via certified mail; be addressed to the last known place of residence or place of business of the alleged violator; specify the statute or rule violated; and state the manner and extent of the alleged violation. A copy of the order may also be sent to a local government unit which may be a party to the action. *Id.*

26. This twenty day delay does not apply to emergency orders. See *infra* notes 31-35 and accompanying text.

Also, the order may, by its own terms, take effect after the twentieth day.

27. IND. CODE ANN. § 13-7-11-2(d) (Burns Supp. 1989).

28. *Id.*

29. *Id.* §§ 4-21.5-1-1 to -6-7.

30. The term "emergency" is used slightly differently for each of the three (3) alternative actions. To request a Governor's order under IND. CODE ANN. § 13-7-12-1(a), the Commissioner must conclude that "contamination of air, water, or land in any area has reached the point where it constitutes a clear and present danger to the health and safety of persons in any area." *Id.* To bring an action on behalf of the state to restrain pollution under IND. CODE ANN. § 13-7-12-2, the Commissioner must receive "evidence that a pollution source . . . is presenting an imminent and substantial endangerment to the health of persons, or to the welfare of persons where such endangerment is to the livelihood of such persons. . . ." *Id.* Finally, in order to provide emergency assistance to abate or remedy a discharge or impending discharge of a contaminant under IND. CODE ANN. § 13-7-12-3(b), the situation must pose "an imminent and substantial danger to the public health or the environment. . . ." *Id.*

31. IND. CODE § 13-7-12-2 (1988).

of such assistance from any person responsible for the emergency.³² Finally, if the commissioner concludes that a pollution emergency is such that it presents a clear and present danger to the health and safety of persons in an area, the commissioner is required to consult with the secretary of the state board of health and jointly request that the governor proclaim an emergency and order all persons causing the emergency situation to immediately discontinue the emissions of contaminants.³³ Presumably, the commissioner may also issue emergency orders directly under authority granted to state agencies in general under the AOPA.³⁴

3. *Citizen Initiated Enforcement.*—Any citizen of the state of Indiana³⁵ may maintain an action for declaratory and equitable relief in the name of the state against virtually anyone³⁶ for the protection of the environment of the state from significant³⁷ pollution.³⁸

Civil penalties for noncompliance may be up to \$25,000 per day for each violation.³⁹ An ongoing offense is considered a separate violation for each day of violation.⁴⁰ Criminal penalties are also provided by the Environmental Management Act for knowingly, willfully, recklessly, or negligently violating the statute or rules.⁴¹

II. SUMMARY OF 1989 LEGISLATION

The single most significant piece of new legislation was the Responsible Property Transfer Law.⁴² That law requires disclosure between the parties to certain real estate transactions (with notice to certain government entities) of hazardous materials used, stored, released, or disposed of on the property before transfer of the land occurs. While

32. *Id.* § 13-7-12-3.

33. *Id.* § 13-7-12-1(a).

34. *Id.* §§ 4-21.5-4-1 to -6.

35. In addition to citizens, other entities authorized under IND. CODE § 13-6-1-1 (1988) to maintain an action under that section include: corporations, partnerships or associations maintaining an office in the state of Indiana; any state, city, town, county, or local agency or officer vested with authority to seek judicial relief; or the Attorney General of Indiana. See *infra* notes 117-30 and accompanying text for discussion of amendments to citizen suit provisions.

36. See IND. CODE ANN. § 13-6-1-1(a)(4) (Burns Supp. 1989).

37. *Id.* Although "significant pollution" has not yet been defined by Indiana case law, it might be suggested that it at least includes violations of Indiana's environmental statutes and rules.

38. See *infra* notes 117-30 and accompanying text for discussion of citizen enforcement in conjunction with the 1989 amendments to IND. CODE § 13-6-1-1 (1988).

39. IND. CODE ANN. § 13-7-13-1(a) (Burns Supp. 1989).

40. IND. CODE § 13-7-13-3(a) (1988).

41. *Id.*

42. 1989 Ind. Acts 1438.

passage of that law was encouraging, the amendment of Indiana's citizen suit provision⁴³ was a disappointment. The amendment further weakened what could have been a major weapon in protecting Indiana's environment. These two bills are discussed here in detail, followed by a summary of other environmental legislation adopted in 1989.

A. Responsible Property Transfer Law

1. *Introduction.*—The most noteworthy environmental statute passed in the 1989 session, at least in terms of its day-to-day impact on practicing attorneys in Indiana, is Senate Enrolled Act 541,⁴⁴ the Responsible Property Transfer Law (RPTL).⁴⁵ The RPTL requires disclosure of certain information to transferees of property where there is reason to believe hazardous materials have been used, stored, released, or disposed of on the property. The RPTL represents Indiana's recognition of, and participation in, an important trend in environmental legislation toward "transaction-triggered" laws. Such laws are aimed at shifting a part of the burden of environmental regulation away from the government controls to the market place by restricting the alienability of property where hazardous materials activity may have taken place.⁴⁶ By imposing disclosure requirements or other restrictions in connection with the transfer of such property, it is thought property owners will be encouraged to clean up contaminated sites. It has long been required by Indiana law and state and federal regulations that the owner of a hazardous waste disposal facility record a statement in the deed to the property indicating that the property was so used, and note restrictions on the use of the property subsequent to the closure of the disposal facility.⁴⁷ The "trans-

43. 1989 Ind. Acts 658.

44. A Senate Bill becomes a Senate Enrolled Act (SEA) and a House Bill becomes a House Enrolled Act (HEA) under Joint Rule 2 of the "Joint Rules For Conducting Business In The Two Houses Of The General Assembly" after the bill has passed both the House and the Senate during a Session of the General Assembly.

45. 1989 Ind. Acts 1438 (codified at IND. CODE ANN. §§ 13-7-22.5-1 to -21 (Burns Supp. 1989)).

46. For a discussion of the "transaction-triggered" approaches taken by various states, see Farer, *Transaction-Triggered ECRA: The New Wave in Cleanup Law*, NAT'L L.J., Feb. 27, 1989, at 24-25; Stevens, *ECRA: Government and Industry Cope with an Evolving Regulatory Program*, 5 TEMP. ENVT'L L. TECH. J. 17 (1986); Stever, *ECRA and Other Restrictions on the Transfer of Hazardous Waste Sites* 151, in THE IMPACT OF ENVIRONMENTAL REGULATION ON BUSINESS TRANSACTIONS (Prac. L. Inst. 1988); Tasher and Kaufman, *A Guide to New Jersey's Environmental Cleanup Responsibility Act*, 3 NAT. RESOURCES AND ENV'T. 26 (1988).

47. See IND. CODE § 13-7-8.5-5(d) (1988); IND. ADMIN. CODE tit. 329, r. 3-46-10(b) (Supp. 1989) and 40 C.F.R. § 264.119 (1988). The authority of IDEM to require such restrictive covenants was broadened by legislation passed in the 1989 session. Senate

action-triggered" statutory requirements imposed by the RPTL and similar laws go further, imposing additional requirements of direct notice to a prospective purchaser of a number of types of properties other than waste disposal facilities holding state or federal permits.

The inspiration for the wide variety of new laws imposing transaction-triggered requirements is the New Jersey Environmental Cleanup Responsibility Act (ECRA).⁴⁸ The requirements of the New Jersey statute go far beyond mere disclosure of information about hazardous substance activity on the covered property. Under ECRA, the New Jersey Department of Environmental Protection (NJDEP) becomes, in effect, a party to certain real estate transactions; a transferor must, before consummating a transfer, satisfy NJDEP that there has been no release of hazardous materials at the site, that any such release has been adequately cleaned up, or submit a cleanup plan for NJDEP approval. If the transferor fails to comply, the transfer may be voided either by a party to it or by NJDEP. Not surprisingly, the intimate involvement of the state environmental bureaucracy in covered real estate transfers entailing delays of months, or sometimes years, has been perceived as extremely burdensome by the regulated community.⁴⁹

Virtually all of the other ECRA-inspired statutes, including the Indiana RPTL and the nearly identical Illinois Responsible Transfer Act,⁵⁰ attempt to avoid such problems by emphasizing full disclosure by the transferor rather than more direct state involvement in the transfer itself. Presumably, if such disclosure is required at the time of the transfer, market forces will encourage the cleanup of contaminated sites, either prior to the sale or pursuant to an agreement by the parties. Regardless of the form of the requirements, the effect upon practitioners is the same; business and real estate lawyers must be prepared to routinely deal with a number of issues which were, until recently, of concern only to the relatively specialized environmental bar.

2. *Disclosure requirements of the RPTL.*—At the heart of the Indiana RPTL is an "Environmental Disclosure Document" which must be provided by a transferor of property subject to the law. The document must be delivered to the other parties to the transfer (including lenders involved in the transaction), recorded in the county where the property

Enrolled Act 370, 1989 Ind. Acts 1414 (codified at IND. CODE ANN. § 13-7-8.7-12 (Burns Supp. 1989)). This authorizes the commissioner of IDEM to require that restrictive covenants be recorded in connection with additional categories of hazardous waste management facilities and other properties where it is suspected that hazardous substances have been handled. *Id.*

48. N.J. STAT. ANN. §§ 13:1K-6 to -13 (West 1983).

49. See, e.g., Stevens, *supra* note 47, at 35.

50. ILL. ANN. STAT. ch. 30, para. 901-07 (Smith-Hurd Supp. 1989).

is located, and filed with the IDEM. The recommended form of the document is set forth in the statute itself.⁵¹ The document elicits information from the transferor concerning a wide variety of hazardous waste-related activities on the property during the transferor's ownership;⁵² the processing, storage, or handling of petroleum; wastewater discharge, air emission, or waste management permits held by the transferor with regard to the property; requirements of the federal Emergency Planning and Community Right-to-Know Act⁵³ to which the transferor has been subject; and certain other state or federal environmental actions to which the transferor, the property, or a facility on the property has been subject. The transferor must also indicate in the document whether any reportable releases of hazardous substances or petroleum occurred on the site during the transferor's ownership, and must (if he or she has knowledge) state whether certain types of waste facilities were operated on the property when it was under prior ownership. Finally, the document must contain a "liability disclosure" advising the transferor and transferee that their ownership or control of the property may render them liable for cleanup costs even if they did not cause or contribute to any environmental problem on the property. The document must be delivered to the parties by the transferor at least 30 days before the transfer, unless the deadline is waived by all the parties to the transfer.⁵⁴ Within 30 days after the transfer, the transferor must file the document with IDEM, and either the transferor or the transferee must record the document with the appropriate county recorder.⁵⁵

3. *Applicability of the Act.*—The applicability of the RPTL to any given transaction turns upon the definition of "property" and "transfer." A wide range of conveyances constitute "transfers" subject to the provisions of the Act, including a conveyance of an interest in property

51. IND. CODE ANN. § 13-7-22.5-15 (Burns Supp. 1989).

52. There is also some reason to believe the RPTL was intended to apply to properties where management of the broader category of "hazardous substances" took place. See *infra* notes 109-14 and accompanying text. The 1990 amendments to the RPTL contained in House Enrolled Act 1391 add two catch-all questions concerning the present owner's activities. New question 9(c) asks whether there is any environmental defect on the property that is not reported in response to questions 9(a) or (b); new question 11 asks whether the transferor ever conducted an activity on the property without a permit, when an environmental management permit would have been required.

53. P.L. 99-499, § 4, 100 Stat. 1614 (1986) (codified at 42 U.S.C. §§ 11022-11050 (Supp. 1987)). That statute requires notification to certain emergency response agencies by facilities which deal with hazardous chemicals.

54. IND. CODE ANN. § 13-7-22.5-10 (Burns Supp. 1989).

55. *Id.* § 13-7-22.5-16. The 1990 amendments in House Enrolled Act 1391 add Ind. Code § 13-7-22.5-22, permitting a property owner to add a statement to property records to the effect that an environmental defect of which notice was previously recorded had been ameliorated.

by (1) a deed or other instrument of conveyance; (2) a lease whose term could be over 40 years if all options are exercised; (3) a contract for the sale of property; (4) an assignment of more than 25 percent of the beneficial interest in a land trust; or (5) a mortgage or collateral assignment of a beneficial interest in a land trust.⁵⁶

While a "transfer" is broadly defined, the definition of "property" subject to the statute includes only three categories of parcels of real estate.⁵⁷ First, the statute applies to property subject to the reporting requirements of the federal Emergency Planning and Community Right-to-Know Act (the Right-to-Know Act).⁵⁸ The Right-to-Know Act requires reporting of a hazardous chemical inventory form by facilities which must prepare Material Safety Data Sheets pursuant to Occupational Safety and Health Administration (OSHA) regulations regarding certain hazardous chemicals. As a practical matter, that definition of "property" will subject virtually all industrial sites to the provisions of the RPTL, because the OSHA regulations cover all employers whose employees are, or may be, exposed to hazardous chemicals in the workplace under normal circumstances or foreseeable emergencies.⁵⁹

The second category of real estate subject to the RPTL is property which is the site of an underground storage tank for which notification is required under state or federal law.⁶⁰ The vast majority of such regulated facilities are gasoline stations and other facilities with petroleum storage tanks; however, underground tanks containing certain "hazardous substances"⁶¹ are also regulated by the underground storage tank laws.

56. *Id.* § 13-7-22.5-7(a). Certain transactions are explicitly excluded from the definition of "transfer" in the RPTL. The term "transfer" does not include: (1) a correction, modification, or supplement, made without additional consideration, to a previously recorded deed or trust document; (2) a tax deed; (3) a deed or trust document of release of property that is security for an obligation; (4) a deed of partition; (5) a conveyance occurring as a result of a foreclosure of a mortgage or lien; (6) an easement; (7) a conveyance of gas, oil, or mineral interests; (8) a conveyance by operation of law upon the death of a joint tenant with right of survivorship; and (9) an inheritance. *Id.* § 13-7-22.5-7(b). The 1990 amendments expanded the definition of "transfer" to include any lease (regardless of term) which includes an option to purchase; a conveyance by a mortgage or trust deed; and it clarifies that a conveyance by "contract" refers to an installment land contract. See note 106, *infra*, and accompanying text.

The 1990 amendments also added to the exclusions to the definition of "transfer". Most notably, the amendments clarified that neither a deed in lieu of foreclosure nor a deed or trust document that changes title without changing beneficial interest is considered a "transfer."

57. *Id.* § 13-7-22.5-6.

58. 42 U.S.C. §§ 11022-11050 (Supp. V 1987).

59. See 29 U.S.C. §§ 651-678 (Supp. V 1987) and 29 C.F.R. § 1910.1200 (1988).

60. See 42 U.S.C. § 6991(a) (Supp. V 1987) and IND. CODE ANN. § 13-7-20-13(a)(8) (Burns Supp. 1989).

61. 42 U.S.C. § 9601(14) (Supp. V 1987).

The third category of subject property includes parcels listed on the Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS).⁶² The CERCLIS is a comprehensive list of sites which might be candidates for Superfund cleanups under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).⁶³ The CERCLIS list is derived from: (1) notices which must be provided to EPA of hazardous substance releases and of facilities where hazardous substances have been treated, stored, or disposed of; (2) cleanup lists created by the states; (3) closed hazardous waste management facilities regulated under the Resource Conservation and Recovery Act (RCRA);⁶⁴ and (4) complaints and petitions by citizens. The CERCLIS list serves as the source from which EPA establishes a priority list of sites which will actually be candidates for Superfund cleanups.

It should be noted that certain facilities which fall within the three categories constituting the definition of covered "property" may not be subject to the RPTL if the facilities have been closed in accordance with the applicable Indiana laws. The RPTL applies only to property "that has not been subject to bonding or other financial assurances released by the appropriate governmental agency after compliance with applicable state laws."⁶⁵ Presumably, that provision refers to financial assurances which are required for regulated underground storage tanks and for hazardous waste treatment, storage, and disposal facilities. Operators of such facilities are required to post bonds or provide other types of financial assurance in order that funding sufficient to pay for proper closure of the facility will be available when the useful life of the facility has ended. Once the state is satisfied that the closure requirements for the facility have been met, the financial assurance requirements are to be released.⁶⁶ Upon such release, the facility is no longer considered "property" subject to the RPTL.

The number of properties included within the three covered categories is not known with precision. Currently, about 1,200 sites are included on the CERCLIS list. The number of properties subject to the other two registration or reporting requirements can only be estimated. IDEM estimates that about 34,000 sites will be subject to the new underground

62. *Id.* § 9616.

63. *Id.* §§ 9601-9661.

64. *Id.* §§ 6921-6939.

65. IND. CODE ANN. § 13-7-22.5-6(1) (Burns Supp. 1989).

66. See, e.g., IND. CODE § 13-7-20-14 (1988) (financial assurance requirements for underground storage tanks); 12 Ind. Reg. 11 (1989) (financial assurance requirements for solid waste disposal facilities, to be codified as IND. ADMIN. CODE tit. 329, r. 2-12); IND. ADMIN. CODE tit. 329, r. 3-47-4 (Supp. 1989) (financial assurance for closure of hazardous waste facilities).

storage tank regulations. Currently, nearly 6,000 facilities have submitted reports under the Right-to-Know Act. However, it is estimated that about 70 percent of the businesses actually *subject* to the reporting requirements (and thus, presumably, included in the definition of "property" for RPTL purposes) have failed to submit the required reports.⁶⁷

4. *Effect of Failure to Provide Disclosure Document.*—A number of penalties and other consequences may flow from the failure to properly complete, submit, record, or file the disclosure document. Even if the document is properly provided in a timely manner, the transaction may be affected by a revelation contained in the document indicating that previously unknown environmental problems exist on the property. First, a transferee or lender may be relieved of any obligation to complete the subject transaction as a result of the transferor's failure to provide the document by the statutory deadline or upon demand of a party subsequent to the deadline,⁶⁸ or if the document reveals defects previously unknown to the transferee or lender.⁶⁹ The RPTL does not permit a party to void the transaction *after* the transfer has been completed, however.⁷⁰ Second, the RPTL provides that a party to a covered transfer may bring a civil action against any other party to the transfer for consequential damages arising from a violation of the law. Costs and attorney fees may also be recovered in connection with such actions.⁷¹ In addition to the general provision allowing civil actions, the RPTL classifies certain violations of the law as "infractions." Failure to deliver the disclosure document in a timely manner is a Class B infraction, and subjects the transferor to a fine of up to \$1,000.⁷² Knowingly making a false statement in a disclosure document is a Class A infraction, with a maximum fine of \$10,000.⁷³ Each day that such a false statement goes uncorrected is a separate infraction. Finally, the failure to record the document in the county where the property is located is also a Class A infraction.⁷⁴ While the RPTL does not explicitly provide for additional

67. Interview with Max Michael, Chief, Prevention Section, Title III Emergency Planning and Community Right-to-Know, Office of Emergency Response, Indiana Department of Environmental Management, in Indianapolis, Indiana, August 16, 1989.

68. IND. CODE ANN. § 13-7-22.5-12 (Burns Supp. 1989).

69. *Id.* § 13-7-22.5-11.

70. *Id.* § 13-7-22.5-14.

71. *Id.* § 13-7-22.5-21.

72. *Id.* § 13-7-22.5-17.

73. *Id.* § 13-7-22.5-18.

74. It should be noted that while most RPTL duties and obligations are imposed upon the transferor, the recording of the document is a joint responsibility of the transferor and transferee. *Id.* § 13-7-22.5-16(c). Curiously, the RPTL does not establish a penalty for the transferor's failure to file the disclosure document with IDEM. Presumably, the general penalty provisions of the Environmental Management Act would apply to such a violation. See IND. CODE § 13-7-13-3 (1988).

civil or criminal penalties, it must be presumed that the general penalty provisions which apply to virtually any violation of the Environmental Management Act, the rules which implement it, or administrative orders issued by IDEM or its governing boards would also apply to violations of the various provisions of the RPTL. For example, the Environmental Management Act establishes penalties of up to \$25,000 per day for a violation of "any provision" of Indiana Code 13-7, any pollution control board rule or standard, or any IDEM determination, rule, or order.⁷⁵ In addition, the Act states that any such violations may also be prosecuted as a Class D felony,⁷⁶ and goes on to provide that knowingly making a "false statement . . . in any . . . document filed or required to be maintained" under Indiana Code 13-7 is a Class B misdemeanor.⁷⁷ The RPTL took effect on January 1, 1990, and applies to transfers which were closed, or scheduled to close, after December 31, 1989.

5. *Issues Arising From the RPTL Provisions.*—The relative novelty of the "transaction-triggered" approach to environmental protection generally, and the untested and sometimes unclear language of the RPTL in particular, give rise to a number of questions and concerns about the meaning and application of the RPTL. The most important concern to the parties involved in a covered transfer is the effect (or, more accurately, the lack of effect) on potential liability under CERCLA of a parcel's apparent clean bill of health with regard to its RPTL disclosure document. Liability under CERCLA⁷⁸ is, or should be, a major concern to many property transferees, especially those taking an interest in an industrial facility or other parcel where hazardous substances may remain on-site. Essentially, CERCLA liability may arise in any situation where the federal government has spent money on a Superfund cleanup, or where the state has incurred similar expenses under its parallel cleanup authority. Joint, several, and strict liability attaches not only to the party who operated the facility at the time hazardous substances were discharged, but also to present owners (regardless of whether they had any involvement in past discharges of hazardous materials) and to any other persons involved in the treatment, transportation, or disposal of the substances involved.⁷⁹ It should be additionally noted that the CER-

75. IND. CODE § 13-7-13-1(a) (1988).

76. *Id.* § 13-7-13-3(a). The felony provisions of the Act establish "strict liability" criminal offenses. "Negligent" violations, as well as intentional, knowing, and reckless acts are punishable under that section.

77. *Id.* § 13-7-13-3(b).

78. The extremely broad CERCLA liability provisions are found at 42 U.S.C. § 9607 (Supp. V 1987). Senate Enrolled Act 370, 1989 Ind. Acts 1414, imposes equally broad liability to the State of Indiana when cleanups are financed by the state rather than by the federal "superfund." See *infra* notes 132-47 and accompanying text.

79. 42 U.S.C. § 9607(a) (Supp. V 1987).

CLA definitions of "owner or operator"⁸⁰ and "hazardous substance"⁸¹ are very broad. Under the CERCLA and Indiana schemes, potential liability arises for the costs of cleanup of the site, other response costs incurred in connection with the discharge, and for damages for related injuries to natural resources.⁸² It is common for CERCLA liability to far exceed the value of the parcel where cleanup was necessary. The CERCLA statute sets forth a small number of strictly limited defenses to Superfund cleanup expense liability.⁸³ Of particular interest in connection with the RPTL is the so-called "innocent landowner" defense⁸⁴ created by the Superfund Amendment and Reauthorization Act of 1986 (SARA).⁸⁵ To establish "innocence" for purposes of the defense, a property owner must be able to show that she took all prudent steps to determine that no hazardous substances were disposed of on the site prior to her purchase of the parcel.⁸⁶ In practice, the necessary, prudent steps have consisted primarily of an "environmental audit," a detailed study of the environmental history of the subject parcel and of its record of compliance with environmental regulations.⁸⁷

While the RPTL requires that useful information be provided to transferees, and gives the transferee an option to cancel the transaction if previously unknown environmental "defects" are discovered,⁸⁸ it must be emphasized that the RPTL disclosure document cannot substitute for an environmental audit of suspect property. For a number of reasons, the disclosure document should not be considered even an implied guarantee that property is free of environmental problems; a careful real estate attorney will continue to insist that an environmental audit be conducted when appropriate, regardless of the contents of the RPTL disclosure document. A major inadequacy of the RPTL document, at least with regard to protecting against CERCLA liability, is that it does not, strictly speaking, address the environmental quality of the property itself; rather, it requires the transferor only to answer a number of

80. *Id.* § 9601(20).

81. *Id.* § 9601(14).

82. *Id.* § 9607(a). *See also* IND. CODE § 13-7-8.7-8 (1988).

83. 42 U.S.C. § 9607(b) (Supp. V 1987)

84. *See id.* §§ 9607(b)(3), 9601(35) (Supp. 1987). For a further discussion of the "innocent landowner" defense, see Leifer, *EPA's Innocent Landowner Policy: A Practical Approach to Liability Under Superfund*, 20 ENV'T REP. (BNA) 646 (1989).

85. Pub. L. No. 99-499, 100 Stat. 1628, 1692 (1986).

86. 42 U.S.C. §§ 9607(b), 9601(35) (Supp. 1987).

87. *See generally* J. MOSKOWITZ, ENVIRONMENTAL LIABILITY IN REAL PROPERTY TRANSACTIONS: LAW AND PRACTICE §§ 16-21 (1989). The 1990 amendments add a disclaimer to the disclosure document, indicating that compliance with the RPTL will likely not be sufficient to protect the transferee as an "innocent landowner."

88. IND. CODE ANN. § 13-7-22.5-11 (Burns Supp. 1989).

questions concerning what she *knows* about the property.⁸⁹ The questions need be answered only to the best of the transferor's "knowledge and belief," and the law nowhere imposes upon the transferor any duty to inquire or to independently verify the information provided. Further, the disclosure document concentrates almost entirely on the *transferor's* activities on the real estate;⁹⁰ however, the CERCLA liability may attach to the current property owner for environmental contamination arising from the activities of prior owners.⁹¹

The disclosure document also fails to elicit some information which might be crucial to a determination of CERCLA liability. A notable example is found in Section III(A)(8) of the document,⁹² which asks whether the transferor, the property, or a facility on the property has ever been subject to the filing of an environmental enforcement action with "a court or the solid waste management board" for which a final order or consent decree was entered.⁹³ While the response to that question will no doubt be of interest to the transferee, as a practical matter, the majority of administrative enforcement actions initiated by IDEM are concluded with consent decrees entered into by the violator and the Department, without the involvement of either the Solid Waste Management Board or the courts.⁹⁴ The document also fails to elicit information about administrative actions that might have been carried out by any number of other entities, such as the air or water pollution control boards, the EPA, or the Indiana Department of Natural Resources.⁹⁵ As such, even a thorough, knowledgeable, and honest response to that portion of the disclosure document could leave a transferee with no protection against CERCLA liability, and in fact, inadequate information even to meet the purpose of the RPTL.

A similar problem may arise from the definition of "property" subject to the RPTL.⁹⁶ As indicated above, property which was previously subject to, and later released from, certain bonding or other financial assurance requirements (for example, financial guarantees of closure and

89. *Id.* § 13-7-22.5-15, Section III A.

90. *Id.* But see *id.* § 13-7-22.5-15, Section III B (requiring the transferor to disclose limited information about activity of prior owners to the extent that the transferor knows of them).

91. 42 U.S.C. § 9607(a) (Supp. V 1987).

92. IND. CODE ANN. § 13-7-22.5-15 (Burns Supp. 1989).

93. *Id.*

94. See generally *id.* §§ 4-21.5-1 to -6 (administrative procedure and judicial review).

95. Kane, *Enactments of the 1989 General Assembly Affecting Environmental Issues* 21, unpublished manuscript of an address to the Indianapolis Bar Association, July 12, 1989.

96. See *supra* notes 59-69 and accompanying text.

post-closure funding for hazardous waste disposal sites⁹⁷ and underground storage tanks⁹⁸) is exempt from the disclosure provisions of the RPTL, apparently on the assumption that the financial assurance requirements would not have been released unless it was certain that the property was free of environmental defects. Where potential CERCLA liability is concerned, that is not a safe assumption. Such financial assurance obligations might have been released in accordance with earlier, less stringent statutes and rules. Further, most such financial assurance requirements were imposed upon facilities which, when they were operational, dealt with the relatively limited category of "hazardous wastes."⁹⁹ The broader category of "hazardous substances,"¹⁰⁰ the discharge of which might give rise to CERCLA liability, is not fully addressed in the various financial assurance statutes and rules which determine whether the RPTL applies to a particular parcel.

A number of issues unrelated to potential CERCLA liability are likely to arise from provisions of the RPTL which are unclear or which have been left undefined. The most significant source of potential confusion (and litigation) in connection with the RPTL is the crucial voidability provision.¹⁰¹ That section provides that the parties to the transfer are not obliged to accept the transfer, or to finance it, if the transferor's disclosure document reveals "environmental defects" that were not previously known to the other parties.¹⁰² In what appears to be a curious omission, the term "environmental defect" is not defined in the RPTL (nor in its Illinois counterpart¹⁰³). As a result, a dispute over whether any information which is revealed in the disclosure document and which is relied upon by a party seeking to void the transfer constitutes an "environmental defect" may be anticipated. It seems clear that a "yes" response to any question asked on the disclosure document cannot, without more, be considered to reveal an "environmental defect."¹⁰⁴ The

97. See generally 40 C.F.R. § 264.140-.151 (1989).

98. See generally *id.* § 280.90-.112.

99. See generally 42 U.S.C. § 6901(5) (Supp. 1987) and 40 C.F.R. § 261 (1989).

100. See *infra* note 113.

101. IND. CODE ANN. § 13-7-22.5-11 (Burns Supp. 1989).

102. *Id.*

103. ILL. ANN. STAT. ch. 30, paras. 901-907 (Smith-Hurd Supp. 1989). The 1990 amendments to the RPTL add a definition of "environmental defect" in new Ind. Code § 13-7-22.5-1.5. An "environmental defect" includes a violation of an environmental law or rule; a situation requiring environmental remedial action; a situation that substantially endangers health, welfare or the environment; a situation which would materially lower the value of the subject property or adjoining property; or a problem that would prevent or interfere with someone else's ability to obtain an environmental permit needed to operate a facility on the property.

104. Kane, *supra* note 96, at 12.

fact that a transferor once held a permit for emissions to the atmosphere, for example, cannot reasonably be seen as evidence of a present "defect" sufficient to justify avoidance of the transfer obligation. Until or unless the RPTL is amended to clarify the term, the burden may fall upon the parties to the transfer to define the relevant "environmental defects" within each transfer agreement.

Another definitional question arises from the application of the RPTL to a "contract for the sale of property."¹⁰⁵ While that section presumably contemplates typical installment land contracts, the absence of any definition of "contract for the sale of property" leaves open the possibility that other kinds of agreements might be subject to the RPTL. For example, if the agreement to purchase real estate which commonly precedes a conveyance by deed is considered such a "contract," the RPTL disclosure document would have to be provided at least 30 days before the parties decided to enter into their purchase agreement, rather than (or possibly in addition to) 30 days prior to the actual conveyance by deed (which is itself defined as an RPTL "transfer"). An overly inclusive interpretation of "contract" could thus cause substantial, unexpected, and unnecessary delays in connection with otherwise routine transactions.¹⁰⁶

Finally, a third definitional issue arises from a provision in the RPTL which is not unclear, but may be erroneous. Section III(A)(1) of the RPTL disclosure document asks whether the transferor has ever "conducted operations on the property which involved the generation, manufacture, processing, transportation, treatment, storage, or handling of 'hazardous waste', as defined by IC 13-7-1."¹⁰⁷ The document then goes on in Section III(A)(3) to ask, without mentioning the consumer goods exclusion, a virtually identical question: "Has the transferor ever conducted operations on the property which involved the generation, transportation, storage, treatment, or disposal of 'hazardous waste', as defined in IC 13-7-1."¹⁰⁸ There are three reasons to believe that Question III(A)(1) of the Indiana disclosure document should have referred to "hazardous substances" rather than "hazardous waste."¹⁰⁹ First, the use of "haz-

105. IND. CODE ANN. § 13-7-22.5-7(a)(5) (Burns Supp. 1989). There is no parallel provision in the Illinois Responsible Transfer Act after which the Indiana statute is modeled. ILL. ANN. STAT. ch. 30, para. 903(g) (Smith-Hurd Supp. 1989) does not address a conveyance by "contract" within the definition of "transfer."

106. See Kane, *supra* note 96, at 6.

107. IND. CODE ANN. § 13-7-22.5-15 (Burns Supp. 1989) (certain consumer goods are excepted).

108. *Id.*

109. See Kane, *supra* note 96, at 21. The 1990 amendments changed the wording of question III (A) (1) to refer to a "hazardous substance."

ardous waste" in the two nearly identical sections of the Indiana document causes the questions to be, for all practical purposes, redundant. Second, "hazardous substances" are referred to elsewhere in the disclosure document as a category distinct from "hazardous wastes."¹¹⁰ Third, the nearly identical Illinois act refers to "hazardous substances" rather than "hazardous wastes" in the section of the Illinois disclosure document which parallels question III(A)(1) of the Indiana document.¹¹¹ The choice of terminology potentially has a tremendous effect on the extent of the RPTL's applicability, because "hazardous substance," as defined in the Indiana, Illinois and federal statutes, is a far more inclusive term than "hazardous waste." The statutory definition of "hazardous substances" includes a far broader range of materials than does the definition of "hazardous waste," and is not limited to materials which have been "discarded." As such, "hazardous substances" may include products in use, as well as discarded "waste."¹¹² Thus, it appears that

110. See IND. CODE ANN. § 13-7-22.5-15 (Burns Supp. 1989), questions III (A)(4) and III (A)(9) of the disclosure document.

111. ILL. ANN. STAT. ch. 30, para. 905 (Smith-Hurd Supp. 1989). Question IV(1) of the Illinois disclosure document, which corresponds to question III (A)(1) of the Indiana document, asks whether the transferor ever conducted operations on the property involving the "generation, manufacture, processing, transportation, treatment, storage, or handling of "hazardous substances" as defined by the Illinois Environmental Protection Act?" *Id.* (emphasis added). Question IV(3) of the Illinois document, which corresponds to question III (A)(3) of the Indiana document, refers (like the Indiana question) to "hazardous wastes" as defined in the appropriate state's environmental protection statute. (The Illinois question also asks about "special wastes," a category which includes certain industrial process waste, pollution control waste, and hazardous waste. See ILL. ANN. STAT. ch. 111 1/2, para. 1003.45 (Smith-Hurd 1988). "Special waste" is also recognized as a separate category by the Indiana solid waste rules, see 12 IND. REG. 1179-83 (1989) (to be codified as IND. ADMIN. CODE tit. 329, r. 2-21), but the Indiana disclosure document does not inquire about special waste.

112. The definition of "hazardous waste" which is referred to in Questions III(A)(1) and III(A)(3) of the Indiana disclosure document is found at IND. CODE ANN. § 13-7-1-12 (Burns Supp. 1989). The statute defines "hazardous waste" as:

a solid waste . . . that, because of its quantity, concentration, or physical, chemical, or infectious characteristics, may: (1) cause or significantly contribute to an increase in mortality or increase in serious, irreversible, or incapacitating reversible, illness; or (2) pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, or disposed of, or otherwise managed."

The definition of "hazardous waste" in the Illinois Environmental Protection Act is nearly identical. See ILL. ANN. STAT. ch. 111 1/2, para. 1003.15 (Smith-Hurd 1988). "Solid waste," in turn, is any "discarded material resulting from industrial, commercial, mining, or agricultural operations or community activities." IND. CODE ANN. § 13-7-1-22 (Burns Supp. 1989). The regulatory definition of "hazardous waste," however, specifically excludes sewage, industrial discharges regulated by the federal water pollution control statutes, certain nuclear waste, and waste resulting from some farming operations. See IND. ADMIN.

the application of the Indiana Act, because of its possibly erroneous reference to "hazardous waste" in Question III(A)(1), might be limited to a much narrower range of properties than was contemplated by legislators intending to adopt legislation similar to the Illinois Act. Until or unless the wording in Questions III(A)(1) and (3) is clarified, transferors might be well advised to err on the side of greater disclosure, responding to Question III(A)(1) as if the broader class of "hazardous substances" rather than the relatively narrow class of "hazardous wastes" was actually the subject of the inquiry.

In addition to the above-mentioned definitional issues left unsettled until the RPTL is interpreted by the courts or clarified by the legislature, two potential practical problems are immediately apparent. First, while the types of "property" subject to the RPTL are relatively clearly defined, a determination of whether a given parcel is included within the definition will, as a practical matter, be difficult. As discussed previously,¹¹³ there is an excellent possibility that the owner of a parcel subject to the underground storage tank or Right-to-Know Act reporting requirements has failed to submit the required reports. Even if information about a property has been reported as required, information about the status of the property may be difficult to obtain. Parties to real estate transactions and their attorneys will, in large part, be dependent upon the already-strained resources of IDEM for information about whether a parcel is on the CERCLIS list, whether it is the site of an underground storage tank, or whether Right-to-Know Act reports have been submitted with regard to the property. While virtually all IDEM records which are not

CODE tit. 329, r. 3-3-4 (1988).

A "hazardous substance," by contrast, is not limited either to "waste" or to "solid" or semi-solid material. Indiana has adopted the CERCLA definition of "hazardous substance," 42 U.S.C. § 9601(14) (Supp. V 1987) and also includes other substances declared hazardous by IDEM. IND. CODE ANN. § 13-7-8.7-1 (Burns Supp. 1989). The Indiana and federal definition of "hazardous substance," as well as the nearly identical Illinois definition found at ILL. ANN. STAT. ch. 111 1/2, para. 1003.14 (Smith-Hurd 1988), encompass the entire category of "hazardous waste" regulated by the Federal Resource Recovery and Conservation Act (RCRA), 42 U.S.C. §§ 6921-6939 (Supp. V 1987) and by the Illinois and Indiana statutes. In addition, "hazardous substances" include substances designated as hazardous by CERCLA regulations pursuant to 42 U.S.C. § 9602 (Supp. V 1987), as well as pollutants regulated under certain provisions of the Clean Air Act, 42 U.S.C. § 7412 (1984), the Water Pollution Control Act, 33 U.S.C. §§ 1317, 1321 (Supp. V 1987), and the Toxic Substances Control Act, 15 U.S.C. § 2606 (1984). So, a "hazardous substance" may include virtually anything the EPA determines may threaten significant danger if released to the environment, whether or not it is "waste" or "solid." Petroleum and natural gas are generally excluded from the definition of "hazardous substance." 42 U.S.C. § 9602(14) (Supp. V 1987). See 40 C.F.R. § 302.4 (1988) (list of CERCLA hazardous substances).

113. See *supra* note 69 and accompanying text.

"trade secrets" or "privileged" are available for public inspection,¹¹⁴ the agency is, in most situations, not obliged to search for and provide such information to members of the public who need it. As a result, a transferor or transferee who is out of state or in areas of Indiana far from the IDEM offices may bear a heavy burden in time and expense in searching IDEM records to determine whether a specific parcel falls within a class of "property" subject to the RPTL provisions.¹¹⁵

A second practical problem arises from the very nature of the CERCLIS list, the placement of property upon which will bring the RPTL requirements into play. While most of the sources of the CERCLIS list suggest that a listed parcel is, indeed, likely to be environmentally "defective," it should be noted that a number of CERCLIS properties are placed on the list solely because citizen complaints have been received. As a result, it is probable that a number of CERCLIS properties pose no environmental threat; the citizen complaints which led to the listing of the property might well have been unrelated to the concerns the RPTL seeks to address, or may simply have been unfounded from an environmental perspective. It is likely, however, that the very fact that a parcel is on the CERCLIS list, and the resulting imposition of the RPTL requirements, could have an occasional "chilling effect" on a prospective transferee, whether or not a factual basis existed for the citizen complaint that resulted in the CERCLIS listing.

6. *Conclusion.*—The disclosure requirements of the RPTL, when properly observed, will no doubt benefit purchasers of most industrial parcels in Indiana by assuring that the purchaser receive certain valuable information about the subject real estate. It must be emphasized, however, that the RPTL serves to provide only information, and not protection from liability which may independently arise from prior environmental

114. IND. CODE §§ 5-14-3-3 to -4, 13-7-6-6 (1988).

115. It should be noted that new Indiana hazardous waste rules will require IDEM to search for and provide some agency records upon request. The rules, 12 Ind. Reg. 2035-46 (1989) (to be codified at IND. ADMIN. CODE tit. 329, r. 3-58) adopt the federal disclosure requirements and provide that IDEM must search for and provide to the requestor certain "hazardous waste records." While it is likely that some of the information pertinent to determining the applicability of the RPTL to a particular parcel of land will fall within the definition of "IDEM hazardous waste record" in IND. ADMIN. CODE tit. 329, r. 3-58-1 (1989), it is doubtful that all three categories of covered "property" will be included. If relevant property information is not within the definition of "IDEM hazardous waste record," an interested prospective transferor or transferee cannot expect IDEM assistance in locating or providing the information. The 1990 amendments add new Ind. Code sec. 13-7-22.5-9.5, which requires IDEM to "provide information" that is in its possession concerning whether a parcel falls within the RPTL definition of "property". The new section does not, however, indicate what service IDEM must provide beyond simply opening its files. The new section also releases the state, IDEM, and IDEM employees from liability for providing incomplete or erroneous information.

damage to the property. A cautious purchaser or lender will thus continue to insist on a thorough environmental audit appropriate to the property.

B. Citizen Suit Provisions

While an increase in the amount of environmental legislation passed shows increased interest in the environment, not all the legislation will necessarily have a positive effect. One disappointing enactment of the 1989 legislative session was House Enrolled Act 1148.¹¹⁶ Sections 2 and 4 of that law, which became effective July 1, 1989, weakened an already anemic "citizen suit" provision.¹¹⁷ The citizen suit statute which allows citizens to act as "private-attorneys general" to bring suit against violators of environmental laws is theoretically an integral part of most states' and the federal government's environmental protection strategies.¹¹⁸ Indiana's provision allows a citizen to "bring an action for declaratory and equitable relief in the name of the state against an individual . . . a company . . . or any other legal entity . . . for the protection of the environment of Indiana from significant pollution, impairment, or destruction."¹¹⁹

An overview of this provision reveals an already weak statutory scheme for citizen suits in Indiana. A citizen suit filed under the Indiana statute may be used only to gain declaratory or equitable relief. No provision for civil penalties or for litigation expenses such as attorney or expert witness fees is provided for in the Indiana statute. Civil penalties are an integral part of any enforcement scheme because the threat of fines for past violation may provide an economic incentive for regulated entities to bring themselves into prompt compliance with the applicable laws. This is especially true in environmental regulation given the considerable expense of compliance. Further, when citizen litigants cannot

116. 1989 Ind. Acts 658.

117. IND. CODE §§ 13-6-1-1 to -6 (1988). An item of note here is the difference between Indiana's citizen suit authority and the provisions set out in the federal environmental laws. The federal provisions allow citizens to sue for civil penalties as well as injunctive relief to provide consistency in the regulatory program implemented by the agency and by the citizens. The federal provisions also allow citizen plaintiffs to recover the costs of the action, including attorney and expert witness fees, when the court deems it appropriate. There is no such provision in the Indiana statute. For an excellent discussion of environmental citizen suits see Miller, *Private Enforcement of Federal Pollution Control Laws*, 13 ENVTL. L. REP. (Envtl. L. Inst.) 10,309 (1983).

118. See generally Hanks, *An Environmental Bill of Rights: The Citizen Suit and the National Environmental Policy Act of 1969*, 24 RUTGERS L. REV. 230 (1969-70); Note, *Standing on the Side of the Environment: A Statutory Prescription for Citizen Participation*, 1 ECOLOGY L. Q. 561 (1971). See also Annotation, *Maintainability in State Court of Class Action for Relief Against Air or Water Pollution*, 47 A.L.R.3d 796 (1973).

119. IND. CODE ANN. § 13-6-1-1(a)(4) (Burns Supp. 1989).

recover reasonable expert witness and attorney's fees, the cost of litigation effectively prohibits all but the wealthiest persons from bringing private enforcement actions. Thus, to earnestly undertake a citizen suit under Indiana law, one must be prepared to suffer substantial financial loss for litigation expenses with the prospect of merely receiving injunctive relief. Absent the authority to recover penalties or the cost of litigation, environmental citizen suits in Indiana's courts are currently prohibitively expensive and unfortunately incomplete tools of enforcement. This seems contradictory to the goal of encouraging private actions as a supplement to government efforts to protect the environment. Federal citizen suit provisions, by contrast, allow for the recovery of civil penalties, attorney's fees and expert witness fees.¹²⁰

As a condition precedent to maintaining an action in Indiana, notice must be given to the Department of Natural Resources, the IDEM, and the attorney general.¹²¹ Those state agencies are then required to notify all state administrative agencies having jurisdiction over or control of the pollution, impairment, destruction, or protection of the environment for which relief is sought.¹²² This notice allows the appropriate agency to institute an administrative action against the alleged violation. These provisions were not changed by the 1989 amendments.

The amendment that could allow a great deal more bureaucratic foot-dragging deleted the requirement that a "final determination" of the administrative action be completed within 180 days after receipt of notice by the Attorney General.¹²³ If the agency failed to meet that 180-day requirement, the citizen suit could then proceed. Either way, the action moved forward to some kind of final determination whether administratively or judicially. The new provision requires only that the agency "commence an administrative proceeding" within 90 days of the citizen's notice.¹²⁴ The new provision may permit indefinite bureaucratic delays. Under the new 90-day rule, an action may not be maintained unless none of the agencies that receives notice of the action commences an administrative proceeding or a civil action on the alleged pollution within 90 days after receiving notice.¹²⁵ In other words, all the government agency need do to halt a citizen suit is to begin "administrative proceedings." Another option to halt a citizen suit is for a notified agency

120. See 42 U.S.C. § 7604 (Supp. V 1987) (Clean Air Act); 33 U.S.C. § 1365 (Supp. V 1987) (Federal Water Pollution Control Act); 42 U.S.C. § 6972 (Supp. V 1987) (Resource Conservation and Recovery Act).

121. IND. CODE ANN. § 13-6-1-1(a) (Burns Supp. 1989).

122. *Id.*

123. IND. CODE § 13-6-1-1(b) (1988).

124. IND. CODE ANN. § 13-6-1-1(b) (Burns Supp. 1989).

125. *Id.* § 13-6-1-1(b)(1)(A); IND. CODE § 13-7-11-2(i) (1988).

to "take steps" within 90 days after receiving notice to have a criminal prosecution commenced. Finally, the agency that commences an administrative proceeding on the alleged pollution must "diligently pursue" the proceeding after it is commenced. In contrast to the previous rule, no time frame is set for a final determination by the administrative agency. A court, moreover, might allow the agency an excessive amount of time to act by broadly interpreting "diligently pursue" because of the constraints within which the agencies are conducting their business.¹²⁶ The Indiana Department of Natural Resources and IDEM are understaffed and underfunded.¹²⁷ The effect of the disincentives in the original citizen suit provision is reflected in the fact that the statute has rarely been used since it was originally passed in 1971.¹²⁸ The 1989 modification of Indiana's citizen suit provision will only further cripple any citizen-enforced environmental protection strategy.

The citizen suit could be a vital part of this state's comprehensive environmental protection strategy, especially considering the scarcity of IDEM resources¹²⁹ and the popularity of environmental protection initiatives. One might think that the legislature would embrace the opportunity to impose the cost of effective environmental enforcement on the parties creating the environmental problems. An adequate citizen suit provision would be a privately administered failsafe system to complement IDEM's underfunded enforcement mechanism.

C. *Property Owner Liability*

Senate Enrolled Act 370¹³⁰ created statutory provisions to make Indiana provisions for clean-up of environmentally contaminated sites more similar to the federal provisions in CERCLA.¹³¹ The amendments were intended to make state law parallel to federal law for liability of property owners¹³² and also to allow the state to place a restrictive

126. Judicial construction of these statutory terms is open to speculation because there is no case law addressing such new legislation. Furthermore, this weakening of Indiana's citizen suit provision seems to be in response to the already rare use of the provision.

127. See *supra* notes 20-22 and accompanying text.

128. See *Sekerez v. United States Reduction Co.*, 168 Ind. App. 526, 344 N.E.2d 102 (1976); *Sekerez v. Youngstown Sheet & Tube Co.*, 166 Ind. App. 563, 337 N.E.2d 521 (1975); *J.M. Foster Co., Inc. v. Northern Ind. Pub. Serv. Co.*, 164 Ind. App. 72, 326 N.E.2d 584 (1975). These are the only reported cases citing Indiana's citizen suit provision. The number of suits or notices filed under this provision is unknown.

129. See *supra* note 22 and accompanying text.

130. 1989 Ind. Acts 1414 (amending IND. CODE § 13-7-1) (1988).

131. See *supra* notes 80-89 and accompanying text.

132. 1989 Ind. Acts 1422 (amending IND. CODE § 13-7-8.7-8) (1988).

covenant on property.¹³³ A person that is liable under section 107(a) of CERCLA for: (1) costs of removal or remedial action; (2) costs of any health assessment or health effects; or (3) damages for injury to or loss of natural resources of Indiana is liable, in the same manner and to the same extent, to the State of Indiana.¹³⁴ Any person that is responsible for a release of hazardous waste and fails, without sufficient cause, to provide removal or remedial action by court order is liable for punitive damages.¹³⁵ The IDEM commissioner may seek punitive damages of up to 300 percent of the total costs incurred by IDEM as a result of the person's failure to properly provide removal or remedial action.¹³⁶ The commissioner of IDEM may compel any responsible person to undertake removal or remedial action.¹³⁷ A restrictive covenant may be placed on property if the commissioner determines that it is necessary for the "protection of the public health or welfare or the environment from unreasonable risk of future exposure to a hazardous substance."¹³⁸ The restrictive covenant may be altered if "a change of conditions or advancements in science or technology permit."¹³⁹

House Enrolled Act 2061¹⁴⁰ provides liability protection for landowners on whose land "garbage or other solid waste (except hazardous waste) has been illegally dumped without the landowner's consent."¹⁴¹ The Commissioner, however, may take enforcement action against the landowner after making "a diligent and good faith effort" to identify, locate, and take enforcement action against a person who appears likely to have committed or caused the illegal dumping.¹⁴² The provision also gives protection to the landowner for providing "good faith" information to the Commissioner about potentially responsible persons. The Commissioner may include the landowner as a party to any enforcement action against an alleged violator.¹⁴³ This permits the Commissioner to allow the alleged violator access to the land to remove and dispose of the solid waste illegally dumped on the land.¹⁴⁴ Finally, the "landowner on whose land garbage or other solid waste has been illegally dumped

133. 1989 Ind. Acts 1425. *See IND. CODE ANN. § 13-7-8.7-12* (Burns Supp. 1989).

134. 1989 Ind. Acts 1422. *See IND. CODE ANN. § 3-7-8.7-9* (Burns Supp. 1989).

135. 1989 Ind. Acts 1423. *See IND. CODE ANN. § 3-7-8.7-10(b)(2)* (Burns Supp. 1989).

136. 1989 Ind. Acts 1423.

137. 1989 Ind. Acts 1422. *See IND. CODE ANN. § 13-7-8.7-9* (Burns Supp. 1989).

138. 1989 Ind. Acts 1425. *See IND. CODE ANN. § 13-7-8.7-12(b)* (Burns Supp. 1989).

139. 1989 Ind. Acts 1425. *See IND. CODE ANN. § 13-7-8.7-12(d)* (Burns Supp. 1989).

140. 1989 Ind. Acts 1434 (amending IND. CODE § 13-7-11) (1988).

141. 1989 Ind. Acts 1434. *See IND. CODE ANN. § 13-7-11-6(a)* (Burns Supp. 1989).

142. 1989 Ind. Acts 1434.

143. *Id.* *See IND. CODE ANN. § 13-7-11-6(b)* (Burns Supp. 1989).

144. 1989 Ind. Acts 1434.

without the landowner's consent may, in addition to any other legal or equitable remedy, recover from the responsible dumper: (1) reasonable expenses incurred by the landowner in disposing of the waste, and (2) reasonable attorney fees."¹⁴⁵

D. Water

House Enrolled Act 1592¹⁴⁶ made minor changes to the procedure involved in the declaration of a ground water emergency by the Director of the Department of Natural Resources (DNR).

The Director of the DNR is required to declare a ground water emergency,¹⁴⁷ by temporary order, if an investigation discloses the well of an owner of a "nonsignificant ground water withdrawal facility"¹⁴⁸ (a facility that has a withdrawal capability of less than 100,000 gallons of ground water in one day) has been adversely affected by the owner of a "significant ground water withdrawal facility"¹⁴⁹ (a facility that has a withdrawal capability of 100,000 gallons or more of ground water in one day). The Director may then restrict the quantity of water that may be extracted by the significant ground water withdrawal facility.¹⁵⁰

Previously, the declaration of the ground water emergency was effective when a copy of the declaration was served upon the owner of the significant ground water withdrawal facility.¹⁵¹ House Enrolled Act 1592 added Indiana Code section 13-2-2.5-6(c) which provides that if a ground water emergency requires action before a copy of the declaration can be served upon the owner of the significant ground water withdrawal facility, then oral notification of the owner by a representative of the DNR is sufficient to make the ground water emergency effective until a copy of the declaration can be delivered to the owner.¹⁵² Oral notification is effective for no more than 96 hours after being delivered.¹⁵³

House Enrolled Act 1592 also specified that the temporary order issued by the Director remains in effect for 90 days unless it is terminated by the Director before that time or is extended under Indiana Code section 4-21.5-4, the Administrative Adjudication Act.¹⁵⁴

145. *Id.*

146. 1989 Ind. Acts 1392 (amending IND. CODE § 13-2-2.5) (1988).

147. 1989 Ind. Acts 1392. *See* IND. CODE ANN. § 13-2-2.5-3(c) (Burns Supp. 1989).

148. IND. CODE § 13-2-2.5-2 (1988).

149. *Id.*

150. 1989 Ind. Acts 1394. *See* IND. CODE ANN. § 13-2-2.5-3.5 (Burns Supp. 1989).

151. IND. CODE § 13-2-2.5-6 (1988).

152. 1989 Ind. Acts 1394.

153. *Id.*

154. 1989 Ind. Acts 1395. *See* IND. CODE ANN. § 13-2-2.5-11(a) (Burns Supp. 1989).

House Enrolled Act 1702¹⁵⁵ added a new chapter to the Indiana Code concerning ground water protection. The Act established the Interagency Ground Water Task Force to coordinate the implementation of the Indiana ground water quality protection and management strategy, study ground water contamination in Indiana, and coordinate efforts among government agencies to address ground water pollution problems.¹⁵⁶ The Task Force is required to make an annual report on its activities to the Governor and the General Assembly.¹⁵⁷

House Enrolled Act 1702 also required the IDEM to establish and operate a ground water clearing house to receive and ensure investigation of complaints about ground water contamination, provide information to the public about ground water and ground water pollution, and coordinate the management of ground water quality data in Indiana.¹⁵⁸ Also, the Water Pollution Control Board is required to adopt a variety of rules regarding ground water. First, before July 1, 1990, the Board must establish ground water quality standards.¹⁵⁹ Second, the Board is required to adopt rules before January 1, 1991, establishing protection zones around community water system wells,¹⁶⁰ and also establishing procedures for the construction and monitoring of surface impoundments used for the storage or treatment of nonhazardous waste and wastewater.¹⁶¹

House Enrolled Act 1261¹⁶² amended Indiana Code section 14-3-1-14, which lists the powers and the duties of the Department of Natural Resources, by adding new language that states the Department of Natural Resources is to cooperate with the IDEM, other state agencies, and local units of government to protect the waters and the lands of Indiana from pollution.¹⁶³ House Enrolled Act 1261 also added a new section to the Code that requires a person or an entity, other than a public or municipal water utility, to obtain a permit from the Department of Natural Resources before filling, erecting a permanent structure in, or removing material from a navigable waterway.¹⁶⁴

Senate Enrolled Act 340¹⁶⁵ established the Water Resources Study Committee, comprised of six state Senators and six state Representatives,

155. 1989 Ind. Acts 1452 (adding IND. CODE § 13-7-26) (1988).

156. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-2 (Burns Supp. 1989).

157. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-2(h) (Burns Supp. 1989).

158. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-4 (Burns Supp. 1989).

159. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-6 (Burns Supp. 1989).

160. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-7 (Burns Supp. 1989).

161. 1989 Ind. Acts 1452. See IND. CODE ANN. § 13-7-26-8 (Burns Supp. 1989).

162. 1989 Ind. Acts 890.

163. 1989 Ind. Acts 890. See IND. CODE ANN. § 14-3-1-14(8) (Burns Supp. 1989).

164. 1989 Ind. Acts 889. See IND. CODE ANN. § 13-2-4-9 (Burns Supp. 1989).

165. 1989 Ind. Acts 1388.

to serve during the One Hundred Sixth Session of the General Assembly. The Committee is to study and make recommendations to the General Assembly on all matters relating to the surface and ground water resources of Indiana.

E. Recycling

House Enrolled Act 1148¹⁶⁶ added a new chapter to the Indiana Code that requires the IDEM Office of Technical Assistance (OTA) to gather and disseminate information on industrial practices that reduce, eliminate, or avoid the generation of hazardous waste in order to reduce risks to human health and the environment.¹⁶⁷ The OTA is to provide this information in response to a request from a business that is active in Indiana and, in the absence of a request, the OTA may present advice on hazardous waste to a business that, in the judgment of the Commissioner of the IDEM, could significantly reduce, eliminate, or avoid the generation of hazardous waste through industrial waste reduction practices.¹⁶⁸ In an effort to aid the OTA with gathering data on the generation and generators of hazardous waste in Indiana, the statute requires a person who submits the required biennial report concerning hazardous waste generation¹⁶⁹ to include additional information in the report concerning the person's hazardous waste generation and the person's industrial operation.¹⁷⁰

House Enrolled Act 1310¹⁷¹ established the Solid Waste Separation and Recycling Projects Fund. If money is available in the Fund, the IDEM may make grants from the Fund to cities, towns, and counties for projects involving solid waste separation or solid waste recycling.¹⁷² The Fund is scheduled to terminate July 1, 1991.¹⁷³

Senate Enrolled Act 415¹⁷⁴ requires state government agencies, including the legislative and judicial branches of state government and state supported colleges and universities, to make reasonable efforts to collect and recycle paper products used by the agencies.¹⁷⁵ The Act also requires state government agencies to procure recycled paper products

166. 1989 Ind. Acts 663 (adding IND. CODE § 13-7-27).

167. 1989 Ind. Acts 663. *See* IND. CODE ANN. § 13-7-27-4(a), (b) (Burns Supp. 1989).

168. 1989 Ind. Acts 663. *See* IND. CODE ANN. § 13-7-27-4(c) (Burns Supp. 1989).

169. *See* 42 U.S.C. § 6922(a)(6) (Supp. V 1987).

170. 1989 Ind. Acts 663 (amending IND. CODE § 13-7-27-7) (1988).

171. 1989 Ind. Acts 2101.

172. *Id.*

173. *Id.*

174. 1989 Ind. Acts 525. *See* IND. CODE ANN. §§ 4-13-4.1-5 and 20-12-67-1 to -3 (Burns Supp. 1989).

175. *Id.*

if recycled paper products are available at the time of a paper products procurement and it is economically feasible to procure those paper products.¹⁷⁶

Senate Enrolled Act 430¹⁷⁷ requires the same state government entities affected by Senate Enrolled Act 415¹⁷⁸ to procure disposable plastic products that are degradable if degradable plastic products are available at the time of a procurement of plastic products, the procurement is appropriate, and the procurement is economically feasible.¹⁷⁹

Beginning January 1, 1992, under Indiana Code Section 13-7-22-1, as added by Senate Enrolled Act 219,¹⁸⁰ a person may not sell a plastic bottle with a capacity of sixteen fluid ounces or more or a rigid plastic container with a capacity of eight fluid ounces or more unless the bottle or container is coded with a three sided triangular arrow with a number in the center and letters underneath indicating the resin from which the bottle or container is made.¹⁸¹ This coding is to assist recyclers in sorting plastic bottles and containers by resin composition.

House Enrolled Act 1926¹⁸² added a new chapter to the Indiana Code, creating the Indiana Institute on Recycling located at Indiana State University.¹⁸³ The Institute is to develop concepts, methods, and procedures to assist in efforts in recycling solid waste in Indiana.¹⁸⁴ The Institute is to be administered by a Board of Governors which consists of seven members representing state and local government, business and industry, and environmental interests.¹⁸⁵ The Board is to report biennially to the General Assembly on the operations, findings, and recommendations of the Institute.¹⁸⁶ The Institute is scheduled to terminate July 1, 1994.¹⁸⁷

F. Regulatory

Senate Enrolled Act 393¹⁸⁸ prohibits the land application of used oil to any ground surface without first obtaining a permit from the IDEM.¹⁸⁹

176. *Id.* IND. CODE 4-13.4-4-7.

177. 1989 Ind. Acts 527.

178. 1989 Ind. Acts 525.

179. 1989 Ind. Acts 528, IND. CODE. §§ 4-13.4-4-6 and 20-12-68.

180. 1989 Ind. Acts 1437.

181. IND. CODE ANN. § 13-7-22 (Burns Supp. 1989).

182. 1989 Ind. Acts 1450.

183. IND. CODE ANN. §§ 13-7-25-3, -4 (Burns Supp. 1989).

184. *Id.* § 13-7-25-5.

185. *Id.* § 13-7-25-6(b).

186. *Id.* § 13-7-25-7.

187. *Id.* § 13-7-25-13.

188. 1989 Ind. Acts 1427 (amending IND. CODE § 13-7-4-1) (1988).

189. IND. CODE ANN. § 13-7-4-1(14) (Burns Supp. 1989).

Senate Enrolled Act 393¹⁹⁰ amended Indiana Code section 13-7-8.5-7(b) which had required a generator of 1,000 kilograms or more of hazardous waste in a month to submit to the Office of Solid and Hazardous Waste Management of the IDEM a copy of the manifest that was created for any transportation of the hazardous waste. Senate Enrolled Act 393¹⁹¹ changed this requirement so that it now applies to generators of as little as 100 kilograms or more of hazardous waste in a month.¹⁹² Senate Enrolled Act 393¹⁹³ also added a requirement that a manifest prepared by and purchased from the IDEM must be used in the transportation of hazardous waste to a treatment, storage, or disposal facility located in Indiana.¹⁹⁴

Senate Enrolled Act 220¹⁹⁵ amended Indiana Code section 13-7-8.6-5 to allow a person who proposes to construct a hazardous waste or low-level radioactive waste facility to apply for a certificate of environmental compatibility from the Hazardous Waste Facility Site Approval Authority before obtaining other required state or federal approval for the facility.¹⁹⁶ Previously, a person was required to obtain all other state and federal approval before applying to the Authority.¹⁹⁷

Senate Enrolled Act 220¹⁹⁸ also added a requirement, which would have become effective July 1, 1992, but was repealed by the 1990 legislature, concerning rules adopted by the Air Pollution Control Board, the Water Pollution Control Board or the Solid Waste Management Board. If a rule adopted by one of those boards had required a plan, study, report, or other technical information prepared on behalf of a person subject to the rule to be certified by a registered professional engineer, the appropriate board would have required that the information be certified by a hazardous materials manager certified by the Institute of Hazardous Materials Management.¹⁹⁹

G. Agency Related

Senate Enrolled Act 548²⁰⁰ amended Indiana Code section 13-7-13-2 concerning the Environmental Management Special Fund. The Envi-

190. 1989 Ind. Acts 1429.

191. *Id.*

192. See IND. CODE ANN. § 13-7-8.5-7(b) (Burns Supp. 1989).

193. 1989 Ind. Acts 1429.

194. IND. CODE ANN. § 13-7-8.5-7(f) (Burns Supp. 1989).

195. 1989 Ind. Acts 1432.

196. *Id.*

197. See IND. CODE § 13-7-8.6-5 (1988).

198. 1989 Ind. Acts 1431 (repealed by P.L. 19-1990).

199. IND. CODE ANN. § 13-7-7-7 (Burns Supp. 1989).

200. 1989 Ind. Acts 1435.

ronmental Management Special Fund is a dedicated environmental fund that may be used by the IDEM after approval of the Governor and the State Budget Director.²⁰¹ As amended, the statute now specifies that fees collected by the Air Pollution Control Board, the Water Pollution Control Board, and the Solid Waste Management Board are to be deposited in the Environmental Management Special Fund instead of continuing to be deposited in the State General Fund.²⁰² Senate Enrolled Act 548 also requires the Auditor of State to issue a report on the Special Fund every four months.²⁰³ A copy of the report is to be forwarded to the IDEM Commissioner, the standing committees of the Indiana House and Senate concerned with the environment, the Environmental Policy Commission, the Air Pollution Control Board, the Water Pollution Control Board, and the Solid Waste Management Board.²⁰⁴

House Enrolled Act 1650²⁰⁵ made several changes to the Wastewater Revolving Loan Program. These changes included amending the Loan Program to allow the Water Pollution Control Board to adopt emergency rules to implement the Program,²⁰⁶ and amending numerous sections of Indiana Code 4-23-21 to allow loans to be made for the planning and designing of wastewater systems, allow the IDEM to sell the creditor's rights connected with the loans and to invest the money in the loan fund in trusteed accounts, allow a political subdivision to issue and sell notes to the IDEM, and allow the IDEM to enhance the obligations of political subdivisions by granting money to be deposited in reserve funds, paying bond insurance premiums or credit enhancement fees, or guaranteeing the obligations.²⁰⁷

H. Air Pollution

House Enrolled Act 1837²⁰⁸ added a new chapter to the Indiana Code concerning radon gas.²⁰⁹ An individual now may not engage or profess to engage in testing for radon gas or abatement of radon gas unless the individual has been certified by the Indiana State Board of Health (ISBH).²¹⁰ Also, the ISBH is required to collect and disseminate

201. IND. CODE § 13-7-13-2(a), (b) (1988).

202. See IND. CODE ANN. § 13-7-13-2(a) (Burns Supp. 1989).

203. *Id.* § 13-7-13-2(c).

204. *Id.*

205. 1989 Ind. Acts 2291.

206. See IND. CODE ANN. § 4-23-21 (Burns Supp. 1989).

207. *Id.*

208. 1989 Ind. Acts 335.

209. IND. CODE ANN. § 13-1-14 (Burns Supp. 1989).

210. *Id.* § 13-1-14-6(b).

information concerning radon gas.²¹¹ The Radon Gas Trust Fund was established to pay the expenses of administering the chapter.²¹²

House Enrolled Act 1905²¹³ revised the enforcement of the auto emissions testing program required in Indiana counties that are not in compliance with ozone air quality standards established by the EPA.²¹⁴ Currently, Clark, Floyd, Lake, and Porter Counties are not in compliance with these standards. House Enrolled Act 1905 replaced the requirement that stickers were to be displayed on a new vehicle to show the vehicle was in compliance with emissions standards with the requirement that a certificate of proof was to be issued and used to prove compliance.²¹⁵ Proof of compliance is now a condition for registering a vehicle with the Bureau of Motor Vehicles (BMV) if the vehicle is located in a county that has not attained the required ozone air quality level.²¹⁶ The BMV must now suspend the registration of a vehicle in a nonattainment county if the vehicle is not in compliance with emissions standards.²¹⁷

House Enrolled Act 1905 repealed the law that required a vehicle that was registered outside of a nonattainment area to be in compliance with the emissions standards in the nonattainment area if the vehicle travelled regularly in the area.²¹⁸ House Enrolled Act 1905 also repealed the civil penalties for noncompliance.²¹⁹

Senate Enrolled Act 505²²⁰ defined clean coal technology as “a technology that is used at an electric generating facility and directly or indirectly reduces airborne emissions of sulfur or nitrogen based pollutants associated with the combustion or use of coal and was not in use in the United States as of January 1, 1989, or had been selected by the United States Department of Energy for funding under the Innovative Clean Coal Technology Program after December 31, 1988.”²²¹ Senate Enrolled Act 505 provides for recovery of preconstruction costs of clean coal technology as operating expenses, construction work in progress reimbursement for clean coal technology, amortization of clean coal technology, and preapproval of clean coal technology by the Utility Regulatory Commission.²²²

211. *Id.* § 13-1-14-4(5).

212. *Id.* § 13-1-14-9.

213. 1989 Ind. Acts 1214-16.

214. IND. CODE ANN. §§ 13-1-1-6 to -12 (Burns Supp. 1989).

215. Compare IND. CODE § 13-1-11-1(b) (1988) with IND. CODE ANN. § 13-1-1-11(b) (Burns Supp. 1989).

216. IND. CODE ANN. § 9-1-4-3.6 (Burns Supp. 1989).

217. *Id.* § 13-1-1-6(b).

218. 1989 Ind. Acts 1213. See IND. CODE § 13-1-1-11(a) (1988).

219. 1989 Ind. Acts 1213. See IND. CODE § 13-1-1-9 (1988).

220. 1989 Ind. Acts 113.

221. *Id.* IND. CODE 8-1-8.7-1.

222. *Id.*

III. FUTURE LEGISLATION

In addition to the bills previously discussed, two bills with potentially major environmental impact were introduced in 1989 but failed to pass. One, Senate Bill 545, dealt with solid waste management and the other, House Bill 1910, dealt with underground storage tanks.²²³

The introduced version of Senate Bill 545 would have required each county, by itself or jointly, to form a solid waste management district and adopt a district solid waste management plan. The bill would have also imposed state fees on the disposal of solid waste and required IDEM to formulate a state solid waste management plan. The basic goal of both the district and state plans was to reduce the amount of solid waste being generated and reduce the amount of solid waste being disposed of in landfills.

The introduced version of House Bill 1910 would have specified the IDEM and the State Fire Marshal to jointly operate the underground storage tank program in Indiana. Also, the State Fire Marshal was to establish a program to certify persons involved in underground storage tank installation, testing, upgrading, and removal. This bill also would have established a program to give financial assistance to owners and operators of underground storage tanks to meet state or federal underground storage tank requirements. Both of these bills were examined by the Interim Study Committee on Environmental Issues during the summer and fall of 1989 and will certainly be discussed during the 1990 Session.

IV. CONCLUSION

Despite an obvious increase in concern about environmental degradation on the part of legislators and the general public alike, the state government has, in large part, failed to either address the major environmental issues with effective legislation or to provide the state's environmental agencies with sufficient staff or funding to effectively administer existing programs. The legislature may also have inadvertently weakened Indiana's environmental protection strategy by effectively denying private citizen participation in the enforcement process. If there is a ray of hope with regard to the future of environmental protection efforts in Indiana, it may be that the state has begun, if hesitantly, to pursue avenues other than traditional regulatory programs in an effort to encourage environmental improvement while shifting the burden of funding and administering such activity from the clearly inadequate state

223. Shortly before the printing of this Article, similar bills were passed by the 1990 Session of the General Assembly.

mechanisms to private industry and individuals. Prime examples of that approach are the "transaction-triggered" disclosure requirements of the Responsible Property Transfer Law and the expanded restrictive covenant provisions of Senate Enrolled Act 370, which aim at achieving environmental compliance by restricting the alienability of property where regulatory requirements have not been adequately observed. Other examples seen in 1989 legislation include "market-based" acts encouraging recycling of paper and plastics and legislation intended to encourage clean coal technology. As noted by former EPA administrator Lee Thomas, "there are limits to how much environmental improvement can be achieved under these [control] programs, which emphasize management after pollutants have been generated."²²⁴ For that reason, EPA's policy has shifted to pollution prevention rather than pollution control.

While the legislature's willingness to turn to somewhat innovative approaches to environmental protection must be applauded, the legislators must realize that disclosure documents and codes on plastic bottles cannot, by themselves, lift Indiana from the cellar it occupies in many national environmental quality rankings. A more comprehensive package of planning, creativity, initiative, and financial support of the regulatory structure sufficient to allow effective administration of existing law must be provided if Indiana is to see improvement in its national standing with regard to environmental protection, or, more importantly, improvement of our land, air, and water.

224. Commoner, "Why We Have Failed," GREENPEACE 12-13 (September/October 1989) (quoting L. Thomas, "Pollution Prevention Policy Statement" (unpublished)).

Survey of Recent Developments in Family Law

MICHAEL G. RUPPERT*

I. INTRODUCTION

A survey of recent developments in "family law" necessarily requires limitation upon the scope of review. The areas of juvenile law, grandparent visitation, paternity, and the guardianship jurisdiction of probate law, while coming within the purview of "family law," have been omitted from this Article. Rather, the focus will be upon the recent cases and legislation concerning dissolution and post-decree issues.

This review is organized around the three incidents of marriage—property, children, and spousal maintenance. The cases and legislation will be discussed according to the development or clarification they bring to these issues.

II. PROPERTY

Property division involves four broad questions: whether something *is* property; whether property is included within the marital estate; the valuation of property; and the distribution of property.¹ The following discussion will address twelve cases reported during the survey period concerning these property issues.

A. Is It Property?

Likening a disability pension to a retirement pension, the Court of Appeals for the Fourth District in *Gnerlich v. Gnerlich*² held that the right to receive private disability insurance payments is property includable within the marital estate. In *Gnerlich*, the husband was completely disabled and was drawing monthly insurance benefits. Tracing the insurance to contributions the husband had made during the marriage to a disability retirement plan, the trial court awarded the

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1. See generally Levy, *An Introduction to Divorce-Property Issues*, 23 FAM. L.Q. 147 (1989).

2. 538 N.E.2d 285 (Ind. Ct. App. 1989).

wife two-thirds of the monthly benefit.³ The husband contended that the definition of "property" contained in the dissolution statute⁴ should be narrowly construed, arguing that inasmuch as the statute did not specifically include disability pensions, the right to receive the benefits was not marital property. He characterized the benefits as future income which may not be considered part of the marital estate subject to division.⁵

The court, while recognizing that the disability benefits were contingent upon the husband's survival and, therefore, contained a compensatory element similar to future earnings, nevertheless held that the value of the disability benefits was property includable in the marital estate. Focusing upon the fact that the value was "readily ascertainable and susceptible to division," the court stated:

Its nature is no more contingent or speculative than an ordinary retirement (longevity) pension—except for one contingency. The benefits depend on William's continued disability. However, because Faye was awarded a percentage of each payment, her interest expires with William's. This contingency does not make William's disability pension speculative or conjectural such that it may not be characterized as a marital asset. . . .⁶

While *Gnerlich* is significant for its broad, rather than narrow, statutory interpretation of "property," it may arguably stand for the

3. *Id.* at 286. In addition to the disability insurance benefits, the husband in *Gnerlich* also received Social Security disability benefits and the mortgage on the marital residence was being paid by yet a third disability benefit. The husband was awarded all the Social Security benefits, and the wife was awarded the marital residence and the disability benefit which paid the mortgage. The division of the disability annuity offered through the husband's employer was the only issue on appeal. *Id.*

4. IND. CODE § 31-1-11.5-2(d) (1988).

5. *Gnerlich*, 538 N.E.2d 285, 286 (citing *Wilcox v. Wilcox*, 173 Ind. App. 661, 365 N.E.2d 792 (1977)).

6. *Gnerlich*, 538 N.E.2d at 288. *But see McNevin v. McNevin*, 447 N.E.2d 611 (Ind. Ct. App. 1983); *Murphy v. Murphy*, 510 N.E.2d 235 (Ind. Ct. App. 1987). *McNevin* involved a personal injury lawsuit brought by the wife against her former husband after the dissolution decree, for injuries suffered in a beating during the marriage. The court held that an unliquidated personal injury claim, even if already filed, could not be considered property which was divided in the dissolution decree (which would extinguish her claim) because it had no present ascertainable value. Any attempt to value the claim would be too speculative; i.e., guessing as to both the husband's liability and the wife's damages. 447 N.E.2d at 618.

Likewise, in *Murphy* the court held that the husband's claim against his employer for benefits under the Longshore and Harbor Worker's Compensation Act was not marital property subject to division. The claim had no fixed value in which the husband had a vested interest. Therefore, the court refused to include the claim in the marital property to be divided because the claim was too speculative and conjectural. 510 N.E.2d at 237.

proposition that disability benefits may *only* be divided by a percentage of the benefit, rather than a present value set off. Only through rationing the actual benefit can the court avoid the inherent inequity of the contingent nature of the asset.

Also focusing on the elements of "property," the court of appeals, in the first district decision of *Porter v. Porter*,⁷ held that a professional practice may be found to have goodwill value, and thus the trial court did not err by including this intangible asset in the valuation of a medical practice.⁸ Although goodwill such as the expectation of continued or habitual patronage is frequently an element in the evaluation of commercial ventures, the propriety of its inclusion in Dr. Porter's medical practice appears to be an issue of first impression for the Indiana appellate courts.

Arguing that the method of evaluating his medical practice was mandated by the terms of a shareholder purchase agreement, Dr. Porter maintained that the "good will" in a professional practice is speculative, non-transferrable, and unmarketable.⁹ Rejecting this as a minority view, the court sided with what it termed the majority view, holding that the goodwill of a professional practice is an asset of the marriage to be distributed upon dissolution.¹⁰

Dismissing the argument that goodwill is too speculative to be capable of valuation, the court held that the value of good will could be determined with the aid of expert testimony and consideration of "such factors as the practitioner's age, health, past earning power, reputation in the community for judgment, skill and knowledge, and his comparative professional success."¹¹

With respect to the husband's argument that goodwill is not readily marketable, the court, citing authority from the State of Washington,¹² concluded that the marketability of goodwill is not dispositive of whether it is includible in the marital estate.¹³ Concluding that an asset may have *value* to a spouse without *marketability*, the *Porter* court noted, with approval, that if a professional were to abandon his practice and relocate in another state, his volume of business would likely decrease though his skill and physical assets would remain the same.¹⁴ "Again,

7. 526 N.E.2d 219 (Ind. Ct. App. 1988).

8. *Id.* at 225.

9. *Id.* at 223.

10. *Id.* at 224-25.

11. *Id.* at 224 (quoting *In re Marriage of Fleege*, 91 Wash. 2d 324, ___, 588 P.2d 1136, 1138 (1979)).

12. *In re Marriage of Lukens*, 16 Wash. App. 481, 558 P.2d 279 (1976).

13. *Porter*, 526 N.E.2d at 225 (quoting *Lukens*, 16 Wash. App. at 485-86, 558 P.2d at 281).

14. *Id.*

the difference must be attributed to his not having developed in his new locale a reputation as to skill, efficiency and the other elements comprising goodwill.”¹⁵

B. Is it Marital or Non-marital Property?

Liberally expanding the definition of “property,” like *Gnerlich*,¹⁶ the Indiana Supreme Court in *In re Marriage of Adams*,¹⁷ held that a police pension came within the statutory definition of “property” even though the husband’s right to receive the benefits did not accrue until after the filing of the petition for dissolution of marriage.

Emphasizing that the pension benefits had been acquired by the joint efforts of the parties during the marriage, the *Adams* decision is intriguing for the succinctness of its analysis. Because a police officer who serves 20 years or more of active duty qualifies for benefits upon his retirement, the court reasoned that “any right to receive pension benefits became ‘not forfeited upon termination’ under section 2(d)(2). . . .”¹⁸

Recognizing that Indiana courts have consistently held that public employees, particularly police officers, have no contractual pension rights until actual retirement, the court noted that its objective was to determine and implement legislative intent. In so doing the court reasoned that the legislature did not intend to exclude police pension benefits for officers with over 20 years of active service who have not yet retired.¹⁹ The more difficult problem faced by the court was overcoming the previously accepted notion that pension property rights found to exist under the definition of property are not subject to distribution under Indiana Code section 31-1-11.5-11(b) because they are property rights acquired after “final separation,” i.e., the date of filing the petition for dissolution of marriage. As if looking at section 11(b) for the first time, the court determined that the statute empowered a trial court to dispose of three types of property—property owned by either spouse prior to the marriage; property acquired by either spouse in his or her own right after the date of marriage and prior to final separation; and, property acquired by the joint effort of the parties. Although a property right may accrue after final separation, it nonetheless may have been acquired by joint effort. “The ‘prior to

15. *Id.*

16. *Gnerlich v. Gnerlich*, 538 N.E.2d 285 (Ind. Ct. App. 1989). See *supra* notes 2-6 and accompanying text.

17. 535 N.E.2d 124 (Ind. 1989).

18. *Id.* at 126 (citing IND. CODE § 36-8-7.5-12 (1988)).

19. *Id.*

'final separation' demarcation applies only to property acquired by either spouse 'in his or her own right.' Thus a trial court could distribute property acquired after the filing of the petition for dissolution if acquired 'by their joint efforts.'"²⁰

Finding the husband's pension to have been acquired through the joint efforts of the parties, the court concluded that it was subject to disposition as marital property, notwithstanding that the pension rights did not become marital "property" under section 2(d) until after the date of separation.²¹

The *Adams* decision has been followed in a decision from the Second District, *In re Marriage of Bickel*,²² holding that military pension benefits accruing after final separation but prior to divorce is property acquired by the joint efforts of the parties as opposed to property acquired by a spouse in his own right after final separation.²³ Additionally, the case of *Tirmenstein v. Tirmenstein*²⁴ applies the same rationale and contains an enlightening discussion of a pension division and distribution. The court upheld the trial court's division of the pension under a formula for distribution which computed the wife's benefits by dividing the number of months during the marriage up to separation by the number of months of service, and dividing that percentage by two.²⁵

A Fourth District Court of Appeals decision, *Sovern v. Sovern*,²⁶ provides practical guidance in the handling of an issue often confronted by practitioners, namely whether property titled to non-parties is actually marital property.²⁷ *Sovern* did not involve allegations of fraudulent transfer. Rather, the husband's parents held title to two parcels of real estate on which the marital residence and the husband's automobile bodyshop were located. The evidence at trial revealed that, although the property was titled in the husband's parents' names, the husband and wife had obtained the necessary improvement permits, contributed most of the money required to construct the home, depreciated the bodyshop on their federal income tax returns, and were the named beneficiaries on the homeowner's insurance policy and casualty insurance policy on the bodyshop.²⁸ Concluding that the husband's parents

20. *Id.* at 126-27.

21. *Id.* at 127.

22. 538 N.E.2d 246 (Ind. Ct. App.), *vacating* 533 N.E.2d 593 (Ind. Ct. App. 1989).

23. *Id.*

24. 539 N.E.2d 990 (Ind. Ct. App. 1989).

25. *Id.* at 992-93.

26. 535 N.E.2d 563 (Ind. Ct. App. 1989).

27. *Id.*

28. *Id.* at 565.

held the property in constructive trust for the parties, its value was included in the marital estate. On appeal, the court held that, because the parents were not parties to the divorce, the trial court lacked the authority to impose a constructive trust over any properties titled to them. However, because the wife was awarded cash rather than the disputed property, the decree of the trial court did not bind the non-parties or affect their interest in any way.²⁹ Therefore, the error alleged by the husband was harmless.³⁰ The decision of the trial court was affirmed.³¹ *Sovern* dictates that the practitioner should take care to join a non-party in a dissolution action if a dispute arises as to the existence of an equitable interest in property ostensibly titled to a non-party.

C. What is it Worth?

*Euler v. Euler*³² is the first “50-50 case” since the 1987 legislation amending Indiana Code section 31-1-11.5-11(c)³³ to provide a rebuttable presumption that an equal division of marital property between parties to divorce is just and reasonable.

In *Euler*, the husband argued that the trial court abused its discretion in dividing the marital property because he was entitled to more than 50% of the net estate. While it appeared that the trial court intended to impose a 50-50 split of the marital property, in fact the husband received more than 50% of the marital property. The reason for such a deviation from the statutory presumption was not explained in the decision of the trial court.

Although the trial court, in the exercise of its discretion, can divide the marital property unequally, the dissolution decree in this case indicates no reason for straying from the presumption of equality. We believe that IND. CODE § 31-1-11.5-11(c) requires the trial court to set forth the basis for a division of marital property which does not follow the fifty-fifty presumption. While the evidence in this case may support a 46/54 division of property, we will not speculate as to the trial court’s reasoning. There-fore, we remand this case to the trial court to divide the marital property equally or to set forth its rationale for dividing the property unequally.³⁴

29. *Id.* at 567.

30. *Id.*

31. *Id.*

32. 537 N.E.2d 554 (Ind. Ct. App. 1989).

33. IND. CODE ANN. § 31-1-11.5-11(c) (West Supp. 1989) (as amended by P.L. 283-1987 Sec. 4).

34. *Euler*, 537 N.E.2d at 556-57.

It is clear from *Euler* that a trial court in a contested proceeding must now make a special finding of fact to support an uneven distribution in a dissolution decree.

Although previously discussed as a "property identification" case³⁵ *Porter v. Porter*³⁶ is also a valuation case. As the first reported Indiana case to recognize that intangible goodwill in a professional practice is a marital asset with potential value, *Porter* also provides a discussion of the factors an attorney must consider when dealing with experts on the goodwill value of a professional practice.³⁷ *Porter* is significant in its application to shareholder purchase agreements in the evaluation process. Rejecting Dr. Porter's argument that the shareholder purchase agreement controlled valuation of this practice, the court noted that such buy-sell agreements were but one method of valuation. The value calculated pursuant to a shareholder or partnership agreement is only a *presumptive* value which may be attacked as not reflective of the true value.³⁸

Although stopping short of mandating that a value be assigned to all assets, the court in *Feitz v. Feitz*³⁹ held that the trial court abused its discretion when it assigned a value in the absence of any supporting evidence.⁴⁰ A business, airplane and stock were valued by a witness, not characterized as an expert, who admitted she had not examined any books or records of the business she was attempting to value. Finding the testimony speculative, the court reversed and remanded to the trial court for lack of evidence supporting the values assigned by the court below.⁴¹

D. How Should Property be Distributed?

The court of appeals upheld the enforceability of a pre-nuptial agreement in *Rose v. Rose*⁴² by affirming the finding of the trial courts that a wife failed to establish a basis for rejecting the agreement. The wife alleged that the husband coerced her into the agreement by threatening not to marry her if she did not sign. The wife further contended that the antenuptial agreement was unenforceable because of the husband's failure to fully disclose his assets and his misrepresentations

35. See *supra* notes 7-12 and accompanying text.

36. 526 N.E.2d 219 (Ind. Ct. App. 1988).

37. *Id.* at 223-25 (citing *Peddycord v. Peddycord*, 479 N.E.2d 615 (Ind. Ct. App. 1985)).

38. *Id.* at 223.

39. 533 N.E.2d 1287 (Ind. Ct. App. 1989).

40. *Id.* at 1289.

41. *Id.*

42. 526 N.E.2d 231 (Ind. Ct. App. 1988).

regarding assets, and because she signed without the benefit of counsel.⁴³ The evidence revealed, however, that the wife had lived with her husband for a period of one year prior to the marriage; that during that time the parties had discussed the necessity of an antenuptial agreement; that the wife never sought outside legal advice on the matter prior to the marriage; and that the wife told the husband she was marrying him for love not money.⁴⁴ The court observed that antenuptial agreements are valid and binding if entered into without fraud, duress or misrepresentation and are not unconscionable: "No absolute duty to disclose the value of all possessions exists when entering into an antenuptial agreement."⁴⁵ The court also found that antenuptial agreements are not *per se* unconscionable solely because enforcement of the agreement leaves one spouse with very little assets.⁴⁶ Accordingly, the court found that the wife failed to prove the existence of any of the factors which will invalidate an antenuptial agreement.⁴⁷ In so doing, however, the court has provided little insight as to what standards it applies to the enforceability of such agreements. Indeed, *Rose* may suggest to the unwary practitioner that there *are* no minimum standards.

In stark contrast to the logical extension of *Rose* is the duty of disclosure found to exist under the facts of *Atkins v. Atkins*.⁴⁸ In *Atkins*, the husband failed to disclose that certain stock awarded to him under a settlement agreement had substantially increased in value as the result of a corporate merger occurring just one day before execution of the settlement agreement and final hearing. The court found that the settlement agreement imposed a mutual duty upon the parties to make a "full and complete disclosure of all pertinent financial and other information about the parties as of the date of the agreement."⁴⁹ The court of appeals noted that a trial court has the discretion to approve a settlement agreement, reasoning that approval is appropriate unless the agreement is the product of "unfairness, unreasonableness or manifest inequity in its terms or that it was procured through fraud, misrepresentation, coercion, duress or lack of disclosure."⁵⁰ The court found that the "failure to disclose when such a

43. *Id.* at 233.

44. *Id.* at 235-36.

45. *Id.* at 235.

46. *Id.*

47. *Id.* at 236.

48. 534 N.E.2d 760 (Ind. Ct. App. 1989).

49. *Id.* at 763.

50. *Id.* at 762 (citing *Stockton v. Stockton*, 435 N.E.2d 586, 589 (Ind. Ct. App. 1982)).

duty exists constitutes constructive fraud. . . ."⁵¹ Therefore, the court reversed that portion of the judgment determining division of property and remanded for a new trial.⁵²

While the concurring decision agreed that a duty to disclose existed under such settlement agreements, the duty pertained only to substantial changes.⁵³ This opinion, while attempting to narrow the majority holding to "substantial changes," makes it clear that the duty to disclose exists up to the moment the agreement is approved by the trial court, regardless of whether the change took place before or after agreement.⁵⁴ Thus, finality of the parties' obligations and rights to each other does not occur until judgment.

The dissent narrowly interpreted the disputed provisions of the settlement agreement, criticizing the majority for its interpretation which had the effect of broadening the language from a duty to disclose assets to a duty to disclose value; it opined that the language used in the agreement created no duty to disclose increases in value.⁵⁵ Finally, the dissent would have characterized the increase in value as property acquired after final separation for which no duty to disclose exists.⁵⁶ However, under the holding of *In re Marriage of Adams*,⁵⁷ that pensions vesting after separation may be property acquired by "joint efforts,"⁵⁸ a substantial increase in the value of an asset, by analogy, can be viewed as the result of "joint efforts."⁵⁹ In any event, the pertinent language from the settlement agreement in *Atkins* is reproduced in the opinion and certainly provides a hindsight-basis for redrafting the relatively standard language in the practitioner's settlement agreement forms in order to solidify the existence of such a duty or avoid it, as the case may be.⁶⁰

Arguably a distribution case, the court in *In re Marriage of Gore*⁶¹ held that a divorce court has inherent authority to impose a receivership as a provisional order to insure compliance with its other provisional orders and to prevent the diversion of assets out of the marital estate.⁶²

51. *Id.* at 763 (citing *Brown v. Indiana Nat'l Bank*, 476 N.E.2d 888, 891 (Ind. Ct. App. 1985)).

52. 534 N.E.2d at 763.

53. *Id.* (Staton, J., concurring).

54. 534 N.E.2d at 763-64 (Hoffman, J., dissenting).

55. *Id.*

56. *Id.*

57. 535 N.E.2d 124 (Ind. 1989).

58. *Id.* at 127.

59. *Atkins*, 534 N.E.2d at 764. See *Tirmenstein v. Tirmenstein*, 539 N.E.2d 990 (Ind. Ct. App. 1989).

60. *Atkins*, 534 N.E.2d at 762.

61. 527 N.E.2d 191 (Ind. Ct. App. 1988).

62. *Id.* at 197.

In *Gore*, the husband repeatedly violated court orders pertaining to business assets, among other matters. The trial court grew tired of wrestling the husband "like an alligator," and appointed a receiver over his business and personal assets.⁶³ On interlocutory appeal, the Fourth District followed a three-prong test for determining the propriety of a receivership over a corporation: (1) the proponent of the receivership must show that an emergency exists requiring that management of a corporation be taken over immediately from those in control; (2) the proponent must demonstrate that irreparable damage and injury is certain to result unless a receiver is appointed; and (3) there must be no adequate remedy otherwise available.⁶⁴ Observing that the evidence showed husband to be operating the business successfully, that there was no showing a receiver could operate the business, and that husband was not likely to dissipate marital assets to the extent that wife's claim on the marital estate could not be satisfied, the court found that a receivership over the business was not warranted.⁶⁵ In so doing, the court upheld the appointment of a receiver over the husband's personal assets, citing its belief that such a receivership would not threaten the value of the marital estate while the appointment of a receiver over the successful corporation might well be such a threat.⁶⁶

As has happened to many practitioners, the parties in *Stolberg v. Stolberg*,⁶⁷ at direction of the court, reached a settlement agreement on the day of trial. Not having time to reduce the agreement to writing, its terms were read into the record orally by the parties. The wife later repudiated the agreement after it had been submitted to the court in written form by her counsel.⁶⁸ The agreement had been reduced to writing by the parties' attorneys and incorporated in the decree. The wife received an unsigned copy of the decree before it was signed by the judge as well as a copy of the decree after it was signed. Six months later, the wife moved to set aside the decree claiming that the husband had misrepresented material facts during discovery negotiations. Making no finding as to the allegation of fraud, the court granted the wife's request for rehearing, and found that there was no agreement in writing between the parties and declared the decree void as it related to property distribution.⁶⁹

63. *Id.*

64. *Id.* at 196.

65. *Id.*

66. *Id.* at 197.

67. 538 N.E.2d 1 (Ind. Ct. App. 1989).

68. *Id.* at 2-3.

69. *Id.* at 3.

Reversing the trial court, the Fourth District noted that property distribution occurs either by written agreement under Indiana Code section 31-1-11.5.10 or by order of the trial court. Citing the language of section 10, the court reasoned:

The statute [Indiana Code section 31-1-11.5.10(a)] on its face requires (a) an agreement between the parties which is (b) reduced to writing. There is no statutory requirement the written agreement need be signed by the parties. Here, the facts indicate such an agreement was made. . . .

While it would have been advisable for the parties to sign the agreement, signatures are not specifically required by Indiana Code section 31-1-11.5-10.⁷⁰

III. CHILDREN OF THE MARRIAGE

Dissolution of a marriage involving children necessarily requires decisions concerning the questions of custody, support and visitation. The child-related questions involve many inter-twining issues. Should custody be sole or joint? How much support should be paid? Who gets to claim the children for tax purposes? What can the custodial parent require the non-custodial parent to do during visitation? The mobility of American families also gives rise to prickly jurisdictional issues. During the survey period, the Indiana courts addressed all of these issues and more. The following discussion concerns the developments the author views as the most significant.

A. Custody

A good case with which to be armed in a situation where all of the circumstances indicate joint custody is workable and appropriate but objected to by one of the parties is *Walker v. Walker*.⁷¹ In that case, both parties sought sole custody of their two and one-half year old daughter. The decree of the court provided for joint legal custody of the child. The order further provided that the child would reside with the father in the marital residence and mother would pay support.⁷² The mother argued on appeal that the court abused its discretion in ordering joint custody because it was not in the best interest of the child and contrary to law because not supported by the evidence.⁷³

70. *Id.* at 3-4.

71. 539 N.E.2d 509 (Ind. Ct. App. 1989).

72. *Id.*

73. *Id.* at 510.

While the record on appeal did indicate some ugly incidents between the mother and father, the court concluded that the trial court could have found them to be of minor importance.⁷⁴ Significantly, the record did not demonstrate any fundamental differences in child rearing philosophies, religious beliefs, or lifestyles. Additionally, the record indicated that both parties demonstrated a willingness and ability to communicate and cooperate regarding the child and lived within close proximity of each other.⁷⁵ The court, admitting its reluctance to affirm an order of the trial court providing for joint custody in the face of an objection by one of the parties, concluded that the evidence did not establish that the parties had made child rearing a battleground and that other factors to be considered in determining whether an award of joint custody would be in the interest of the child did not indicate an abuse of discretion.⁷⁶

The Third District decided two cases involving Indiana's version of the Uniform Child Custody Jurisdiction Act ("UCCJA")⁷⁷ which reversed the trial court for assuming jurisdiction. In *In re Cox*,⁷⁸ the father of the parties' children went to their mother's home in Kentucky and took the children back to Indiana with him after being advised by the mother's second husband that the mother had left the home and her whereabouts were unknown. Although the initial custody order was entered in Kentucky, the father brought the children to Indiana where he resided and filed a petition seeking an emergency temporary

74. *Id.* at 510-11.

75. *Id.* at 511.

76. *Id.* at 512-13. Guidance for the appropriateness of joint legal custody is found at IND. CODE § 31-1-11.5-21(g) (1988):

- (g) In determining whether an award of joint legal custody would be in the best interest of the child, the court shall consider it a matter of primary, but not determinative importance that the persons awarded joint custody have agreed to an award of joint legal custody. The court shall also consider:
- (1) the fitness and suitability of each of the persons awarded joint custody;
 - (2) whether the persons awarded joint custody are willing and able to communicate and cooperate in advancing the child's welfare;
 - (3) the wishes of the child and whether the child has established a close and beneficial relationship with both of the persons awarded joint custody;
 - (4) whether the persons awarded joint custody live in close proximity to each other and plan to continue to do so; and
 - (5) the nature of the physical and emotional environment in the home of each of the persons awarded joint custody.

IND. CODE § 31-1-11.5-21(f) (1988), which defines joint legal custody, states that the term means the sharing of the "authority and responsibility for the major decisions concerning the child's upbringing, including the child's education, health care, and religious training. *Id.*

77. IND. CODE §§ 31-1-11.6-1 to -25 (1988).

78. 536 N.E.2d 520 (Ind. Ct. App. 1989).

modification of child custody. He made no attempt to modify custody in Kentucky.⁷⁹ The trial court issued an *ex parte* order granting the husband's petition and issued an order for the mother to appear before the court and show cause why the Kentucky child custody order should not be modified.

The mother filed a motion to dismiss for lack of subject matter jurisdiction.⁸⁰ A hearing was held on the motion to dismiss and the court denied the motion finding that it had jurisdiction under Indiana Code section 31-1-11.6-3(a)(2),⁸¹ commonly known as the "significant connections" basis of jurisdiction.⁸² On appeal, the court described the case as "a prime illustration of jurisdiction which exists but may not be exercised."⁸³ While the court did not dispute the finding of the trial court that the significant connections test had been met, it pointed out that Kentucky retained jurisdiction under the home state test.⁸⁴ When an initial custody decree has been rendered, jurisdiction is no longer determined under section 3 of the UCCJA.⁸⁵ Rather, it is determined under either section 8 of the Act, which the court found inapplicable to the facts before it, or under section 14 of the Act.⁸⁶ Section 14 requires that "Indiana refrain from modifying a child custody decree entered in another state which: Had jurisdiction at the time the decree was entered; has continuing jurisdiction at the time the action

79. *Id.* at 521.

80. *Id.* at 521-22.

81. IND. CODE § 31-1-11.6-3(a) (1988) states:

A court of this state which is competent to decide child custody matters has jurisdiction to make a child custody determination by initial or modification decree if:

* * *

(2) it is in the best interest of the child that a court of this state assume jurisdiction because (A) the child and his parents, or the child and at least one (1) contestant have a significant connection with this state, and (B) there is available in this state substantial evidence concerning the child's present or future care, protection, training, and personal relationships.

82. *Cox*, 536 N.E.2d at 522.

83. *Id.*

84. *Id.* at 523.

85. IND. CODE § 31-1-11.6-3(a)(1) (1988) provides:

A court of this state which is competent to decide child custody matters has jurisdiction to make a child custody determination by initial or modification decree if:

(1) this state (A) is the home state of the child at the time of commencement of the proceeding, or (B) had been the child's home state within six(6) months before commencement of the proceeding and the child is absent from this state because of his removal or retention by a person claiming his custody or for other reasons, and a parent or person acting as parent continues to live in this state.

86. IND. CODE § 31-1-11.6-14 (1988).

to modify was filed in this state; and, provides for the right to modification.”⁸⁷ In short, the issue was whether Kentucky met the prerequisites for continuing jurisdiction. The court noted prior decisions in which it held that the home state test continued to be met for an additional six months after children left the home state if a parent continued to reside in that state. Thus, Kentucky still had jurisdiction under the home state test. Furthermore, the court found that Kentucky also met the significant connections test as an additional basis for continuing jurisdiction.⁸⁸ Because Kentucky had jurisdiction over the initial custody decree, possessed continuing jurisdiction and provided for modification of custody, the court held that the trial court’s assumption of jurisdiction was error.⁸⁹

Presiding Judge Gerard, in a partial concurrence,⁹⁰ cut through the elaborate analysis of the majority and very simply noted that the Parental Kidnapping Prevention Act (“PKPA”)⁹¹ “prohibits a foreign state from exercising jurisdiction on the basis of the significant connection test so long as another state continues to have jurisdiction under the home state test.”⁹²

The other case decided by the Third District is *Sixberry v. Sixberry*.⁹³ In that case, the mother and father were married in Texas in 1982. Their only child was born in Texas in 1983 where they lived for the next five years. The father moved to Indiana and then the mother and child moved to Indiana on January 17, 1987. On June 17, 1987, the mother returned with the child to Texas.⁹⁴ In July, the husband filed a petition for dissolution of marriage and for custody of the child in the Allen County Circuit Court. The wife filed a motion to dismiss contending that Indiana did not meet either the home state or significant connection tests for jurisdiction under the UCCJA.⁹⁵ The husband contended, first, that the home state requirement, *i.e.* the state in which the child has most recently resided for at least six consecutive months,⁹⁶ was met if any part of a calendar month was counted as constituting a month within the meaning of the definition. The court disagreed,

87. 536 N.E.2d at 523.

88. *Id.*

89. *Id.*

90. *Id.* at 525.

91. 28 U.S.C. § 1738A (1982).

92. 536 N.E.2d at 525 (Garrard, P.J., concurring in part and dissenting in part). See also *Thompson v. Thompson*, 484 U.S. 174 (1988) and 28 U.S.C. § 1738A(c)(2)(B)(i) (1982).

93. 540 N.E.2d 95 (Ind. Ct. App. 1989).

94. *Id.* at 96.

95. *Id.*

96. IND. CODE § 31-1-11.6-2(5) (1988).

holding that "'six consecutive months' as used in this statute means a period of six full months, e.g. from January 17, 1987 through July 16, 1987."⁹⁷ With respect to the husband's second contention, the court concluded that the child's five month residency in Indiana was insignificant compared to connections she had with Texas where she lived for five years and was attending school at the time of filing of the petition for dissolution of marriage.⁹⁸ Noting that the prime purpose of the UCCJA is to allow child custody decisions to be made by the court with the greatest access to relevant information, the court found that the purposes of the UCCJA would best be served if a Texas court accepted jurisdiction over the dispute. Accordingly, the decision of the trial court denying the mother's motion to dismiss was reversed.⁹⁹

Turpen v. Turpen,¹⁰⁰ decided by the First District, is a custody case with disturbing implications. The court acknowledged the presumption that, barring a finding of unfitness,¹⁰¹ it is in the child's best interest to be in the custody of a surviving natural parent upon the death of the custodial parent. *Turpen*, however, goes on to depart from the rigorous three-part test established in *Hendrickson v. Binkley*¹⁰² for third party-natural parent custody disputes.¹⁰³ More importantly, however, the court also ignored the burden of proof standard established in *Hendrickson*, namely, that the presumption in favor of the natural parent must be overcome by clear and cogent proof.¹⁰⁴ Never addressing

97. 540 N.E.2d at 96.

98. *Id.* at 96-97.

99. *Id.*

100. 537 N.E.2d 537 (Ind. Ct. App. 1989).

101. *Id.* at 538.

102. 161 Ind. App. 388, 316 N.E.2d 376, *trans. denied, cert. denied* (1974), 423 U.S. 868 (1975).

103. This three-step process was succinctly stated as follows:

First, it is presumed it will be in the best interest of the child to be placed in the custody of the natural parent. Secondly, to rebut this presumption it must be shown by the attacking party that there is (a) unfitness, (b) long acquiescence, or (c) voluntary relinquishment such that the affections of the child and the third party have become so interwoven that to sever them would seriously mar and endanger the future happiness of the child. The third step is that upon a showing of one of these above three factors, then it will be in the best interest of the child to be placed with the third party.

Hendrickson, 161 Ind. App. at 392, 316 N.E.2d at 380. This rule has been involved in numerous cases. See, e.g., *Brown v. Brown*, 463 N.E.2d 310 (Ind. Ct. App. 1984); *Williams v. Throwbridge*, 422 N.E.2d 331 (Ind. Ct. App. 1981); *In Re Phillips*, 178 Ind. App. 220, 383 N.E.2d 1056 (1978); *Stevenson v. Stevenson*, 173 Ind. App. 495, 364 N.E.2d 161 (1977).

104. In the typical custody case between natural parents, whether the case involves an initial determination or a modification, the burden of proof required is a prepon-

the burden of proof question, the court, acknowledging that "this case is a close one,"¹⁰⁵ implicitly applied a lesser standard of proof. Perhaps realizing the difficulties this case may present, the court stated:

We depart from these decisions only to the extent that they suggest to litigants that the trial court must employ a mechanical approach in evaluating the evidence before it. As we have indicated, the cases which have generated the rule applied in our appellate decisions have not required trial courts to apply these principles so rigidly.¹⁰⁶

Turpen is troublesome because as it comes dangerously close to the proposition that the "best interest" of the child is no longer *presumed* to be with a merely adequate, natural parent. Rather, the fact that a potential third party custodian may be able to provide a better home was a seemingly sufficient basis upon which to award custody.

B. Child Support

In *O'Neil v. O'Neil*,¹⁰⁷ an Indiana Supreme Court decision, the custodial parent appealed an order, which increased child support retroactively to the date she had filed her petition for modification while at the same time allowing a partial support reduction upon the emancipation of each of the parties' children. Also appealed was the order of the trial court permitting the offset of voluntary direct contributions to the children's college educational expenses against a child support arrearage.¹⁰⁸

derance of the evidence. However, in a custody dispute between a third party and the natural parent, the burden of proof is greater:

[I]n custody cases, especially as here where a certain maine permanency of custody is involved, the court cannot determine that it is in the best interests of the child to be placed within the custody of a third party, as against the presumption favoring the natural parent, unless the trial court has first determined from clear and cogent evidence that there is either unfitness of the appellant, long acquiescence, or voluntary relinquishment. If the "best interest rule" was the only standard needed without anything else, to deprive the natural parent of custody of his own child, then what is to keep the government or third parties from passing judgment with little, if any, care for the rights of natural parents. In other words, a child might be taken away from the natural parent and given to a third party simply by showing that a third party could provide the better things in life for the child and therefore the "best interest" of the child would be satisfied by being placed with a third party.

Hendrickson, 161 Ind. App. at 393, 316 N.E.2d at 381.

105. *Turpen*, 537 N.E.2d at 540.

106. *Id.*

107. 535 N.E.2d 523 (Ind. 1989).

108. *Id.* at 523-24.

The court of appeals affirmed the order of the trial court in its entirety.¹⁰⁹ On transfer, the Indiana Supreme Court agreed that the reduction of support upon emancipation did not violate the rule against retroactive modification.¹¹⁰ It rejected, however, the decision of the trial court to give the father credit for voluntarily assumed educational costs. Noting the general rule that a parent obligated to pay support will not be allowed credit for payments not conforming to the support order, the court held that the gratuitous payments did not come within the narrow exceptions to this rule, *i.e.*, payment of support directly to the custodial parent rather than through the court clerk, alternate methods of payment which substantially comply with a support order, and in-kind support where the obligated parent, by agreement with the custodial parent, takes the child into his home and assumes the child's custody for an extended period of time.¹¹¹

*Blickenstaff v. Blickenstaff*¹¹² provides a concise primer of the law pertaining to support modification. The mother in *Blickenstaff* appealed the denial by the trial court of her petition to increase the amount of child support. On appeal, the court concluded that the trial court had failed to consider the totality of the circumstances in ruling upon the mother's petition. Specifically, the court enumerated the following factors for consideration: "Everyday knowledge" of changes in the cost of living;¹¹³ the truism of judicial knowledge that older children require more support than younger children;¹¹⁴ and, the lack of evidence mitigating against an increase in support.¹¹⁵ Accordingly, the case was remanded to the trial court with instructions to reconsider the petition in light of the totality of the circumstances.¹¹⁶

In *Beeson v. Beeson*,¹¹⁷ "a unique question in Indiana case law, *i.e.*, whether a trial court can abuse its discretion by awarding inadequate child support," was considered.¹¹⁸ As a matter of course, the court pointed out that child support decisions are within the sound discretion of the trial court and will not be reversed unless against the clear logic and effect of the facts and circumstances before the trial court.¹¹⁹ The argument on appeal was whether the child support awarded

109. *Id.* at 523.

110. *Id.*

111. *Id.* at 523-24.

112. 539 N.E.2d 41 (Ind. Ct. App. 1989).

113. *Id.* at 44.

114. *Id.*

115. *Id.*

116. *Id.* at 45.

117. 538 N.E.2d 293 (Ind. Ct. App. 1989).

118. *Id.* at 296.

119. *Id.*

was inadequate in light of the great disparity between the parties' income. The court noted, however, that the *needs* of the child are the primary focus in awarding child support.¹²⁰ The evidence presented by the mother failed to demonstrate that the child's needs, and the maintenance of the daughter's standard of living, mandated higher support. While the disparity in the financial conditions of both parents was substantial, the court held that the support, under the circumstances, was not illogical or unreasonable.¹²¹

Addressing the allocation of an income tax dependency exemption to the non-custodial father, the court in *In re Marriage of Davidson*¹²² agreed with wife's contention that the trial court had no authority to make such an allocation. Specifically, the wife argued that the Federal Internal Revenue Code¹²³ automatically allocates the child dependency exemption to the custodial parent unless expressly waived by that parent and that therefore state courts are no longer free to allocate the exemption to the non-custodial parent.¹²⁴ This aspect of *Davidson* appears to be in direct conflict with *Blickensstaff* which was decided by the Second District Court of Appeals during the survey period.¹²⁵ In *Blickensstaff*, the father was awarded the deduction by a modification decree entered in 1987. Notwithstanding its observance that the Internal Revenue Service apparently honors only such decrees if entered prior to 1985, the court stated, "[W]e find no basis upon which to hold the modification order to be an abuse of discretion as to the tax deduction division."¹²⁶

The facts in *Davidson* presented the court with an excellent opportunity to consider whether a trial court has the authority to order the custodial parent to execute a written waiver of the dependency presumption:

We are not surprised that the trial court awarded the tax exemption to Robert. Carol testified that she had been unemployed for the past nine years and was physically unable to earn an income due to her poor state of health. The tax exemption will entitle Carol to nothing since she has no earnings to which the exemption can be applied.¹²⁷

120. *Id.*

121. *Id.*

122. 540 N.E.2d 641 (Ind. Ct. App. 1989).

123. I.R.C. § 152(e) (1989) (amended by the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 423(a)).

124. 540 N.E.2d at 647.

125. *Blickensstaff*, 539 N.E.2d at 45. See *supra* notes 102-06 and accompanying text.

126. 539 N.E.2d at 45.

127. *Davidson*, 540 N.E.2d at 647.

Nonetheless, the court failed to address the waiver issue broadly, holding that the trial court had erred by awarding the exemption to the father.¹²⁸

In *Wright v. Brown*,¹²⁹ James Wright appealed the entry by the trial court of a money judgment against him for support arrearages based upon an Illinois support order. Because the arrearages had not been reduced to judgment in Illinois, Wright claimed that his former wife had failed to state a claim upon which relief could be granted. The Court of Appeals for the Second District disagreed, noting that unpaid installments of court-ordered child support constituted a debt and, where entered by a court of a sister-state, are entitled to full faith and credit by the courts of this state even though prior to judgment.¹³⁰

Probably the most significant development in the area of child support during the survey period is the issuance by the Supreme Court of Indiana of its Order Adopting Child Support Rules and Guidelines, effective October 1, 1989.¹³¹ Pursuant to the Child Support Enforcement Amendment of 1984, all states were required to adopt formulas for child support awards by October 1, 1987.¹³²

The court promulgated three support rules. The first rule adopts the third edition of the Indiana Child Support Guidelines which contains five guidelines, commentary, a work sheet and schedules for support.¹³³ The second rule establishes a rebuttable presumption that the amount

128. *Id.* But see the Second District's latest pronouncement, decided after the survey period, holding that the trial court *can* order the custodial parent to execute the IRS waiver and enforce the order by contempt or reduction of ch.7d support. *In re Marriage of Baker*, 550 N.E.2d 82, 86 (Ind. Ct. App. 1990).

129. 528 N.E.2d 824 (Ind. Ct. App. 1988).

130. *Id.* at 825.

131. IND. CHILD SUPPORT GUIDELINES (3d ed. 1989), *reprinted in* 541-43 N.E.2d XXXI (West's Ind. Cases) [hereinafter CHILD SUPPORT GUIDELINES]. Drafted by the Judicial Administration Committee and adopted by the Board of the Judicial Conference of Indiana. The third edition of the Guidelines is effective October 1, 1989 pursuant to Chief Justice Randall T. Shepard's order of August 31, 1989.

132. Pub. L. No. 98-378 (codified at 42 U.S.C. § 667). For a discussion of the history, use and application of child support guidelines, see Phelps and Miller, *The New Indiana Child Support Guidelines*, 22 IND. L. REV. 203 (1989). Care should be taken to utilize the proper edition of the guidelines. The Supreme Court's order specifically adopts the Indiana Child Support Guidelines (Third Edition, 1989), as drafted by the Judicial Administration Committee and adopted by the Board of the Judicial Conference of Indiana.

133. Support Rule 1 provides:

The Indiana Supreme Court hereby adopts the Indiana Child Support Guidelines (Third Edition, 1989), as drafted by the Judicial Administration Committee and adopted by the Board of the Judicial Conference of Indiana, as the child support rules and guidelines of this Court.

Child Support Guidelines, 541-43 N.E.2d at XXXII.

of support determined under the worksheet of the guideline and schedules is the correct amount of support to be awarded.¹³⁴ The third rule expressly requires the court to enter a written finding setting forth the factual circumstances supporting a conclusion that the amount of support required by application of the guidelines would be unjust.¹³⁵ While it reasonably may be anticipated that application of this rule will form the basis of future appellate decisions in Indiana, the guideline level of support in any given case will, however, form the bench mark for the establishment of all support orders.

Arguably, determination of guideline level support subsumes within its calculation three of the four statutory factors to be considered by a court when determining support.¹³⁶ Although the first three factors to be considered under the statute leave considerable room for disagreement in determining the guideline level of support, the fourth factor is not considered on an individualized basis in the guidelines. Instead, if the needs of a non-custodial parent are the basis for a deviation from the guideline level of support, that parent would bear the burden of supplying the court with a sufficient basis upon which to base such a deviation. Additionally, agreed child support orders "submitted to the court must also comply with the 'rebuttable presumption' requirement; that is, the order must recite why the order deviates from the Guideline amount."¹³⁷ While the reasons for deviations from the guide-

134. Support Rule 2 provides:

In any proceeding for the award of child support, there shall be a rebuttable presumption that the amount of the award which would result from the application of the Indiana Child Support Guidelines is the correct amount of child support to be awarded.

Id.

135. Support Rule 3 provides:

If the court concludes from the evidence in a particular case that the amount of the award reached through application of the guidelines would be unjust, the court shall enter a written finding articulating the factual circumstances supporting that conclusion.

Id.

136. IND. CODE § 31-1-11.5-12(a) (1988) provides:

In an action pursuant to section 3(a), 3(b), or 3(c) of this chapter, the court may order either parent or both parents to pay any amount reasonable for support of a child, without regard to marital misconduct, after considering all relevant factors including:

- (1) the financial resources of the custodial parent;
- (2) the standard of living the child would have enjoyed had the marriage not been dissolved or had the separation not been ordered;
- (3) the physical or mental condition of the child and the child's educational needs; and
- (4) the financial resources and needs of the non-custodial parent.

137. *Child Support Guidelines*, 542 N.E.2d at XXXVIII.

line amount are limitless, some probable reasons for deviation can be found in the commentary to Support Guideline 1. These include the non-custodial parent providing child care or purchase of school clothes; the non custodial parent spending a considerable amount of time with the child; the non-custodial parent having extraordinary medical expenses; and the custodial parent moving a substantial distance from the non-custodial parent who must incur significant travel expenses for visitation.¹³⁸

The practitioner should also note that the addition of the guidelines adopted by the Indiana Supreme Court requires the submission of a worksheet, signed under penalties for perjury by the parties, as a verification of income. The worksheet is required in all cases regardless of whether the parties agree upon support or whether it is contested. The worksheet must be accompanied by documentation of current and past income.¹³⁹

C. Visitation

In *Beeson v. Beeson*,¹⁴⁰ the court also addressed in its opinion the issue of whether a stipulation regarding visitation is binding on the court. The court reiterated the well-established proposition that visitation is an element of a custody order and that the court, when determining custody and visitation rights, must be mindful that the best interest of the child is paramount. Thus, a stipulation cannot place restrictions upon the duty of the court to protect the child's best interest.¹⁴¹ Because the wife failed to demonstrate that the visitation rights ordered by the court were not in the child's best interest or that the order was otherwise illogical or unreasonable, the visitation order was affirmed.¹⁴²

Also addressing the issue of visitation, the court in *In re Marriage of Davidson*¹⁴³ confronted a mother's contention that the trial court erred in finding that "no one can be required to attend religious services as a condition to visitation," in response to her request that the husband be required to transport their child to catechism classes and mass during his visitation.¹⁴⁴ In holding that the trial court did not abuse its discretion in failing to require the husband to transport

138. *Id.* at XXXVIII-IX.

139. *Id.*

140. 538 N.E.2d 293 (Ind. Ct. App. 1989).

141. *Id.* at 298-99.

142. *Id.* at 299.

143. 540 N.E.2d 641 (Ind. Ct. App. 1989).

144. *Id.* at 650.

the child during visitation,¹⁴⁵ the court clarified its prior holding in *Overman v. Overman*¹⁴⁶ in which the opposite result was reached under essentially the same facts. The court explained that in the *Overman* decision “[w]e observed that absent an unreasonable interference with the non-custodial parent’s visitation rights, the custodial parent’s right to choose religious training was paramount.”¹⁴⁷ The refinement on this point of the law is the teaching of the court regarding the burden of going forward with the evidence:

However, when the circumstances place the interests of the custodial and non-custodial parents in direct conflict with one another, we believe it proper to place the burden of going forward with the evidence to establish the basis and facts which will enable the trial court to make an appropriate ruling upon the party seeking the intrusion or asking the accommodation. Thereafter, once the custodial parent has met the burden of going forward, the burden falls upon the non-custodial parent to prove that the request would create an unreasonable interference with his visitation rights.¹⁴⁸

Because the mother failed to meet her burden, the denial by the court of her request to intrude upon the husband’s visitation was upheld. This holding should logically extend to other potential intrusions upon a non-custodial parent’s visitation, the most obvious of which is the involvement of the child in extracurricular sports activities that are scheduled to occur at the same time as visitation. Some parents may view participation in sports or special educational opportunities as equally essential to a child’s development as religious training. Where regular participation is expected, a child might naturally feel singled-out if he or she is required to miss participation on a periodic basis in order to accommodate visitation. Thus, *Davidson*, when combined with the holding in *Overman*, provides an analytical framework for resolving the competing interest of the non-custodial parent’s right to visitation and the custodial parent’s right to make the major child-rearing decisions.

145. *Id.* at 651.

146. 497 N.E.2d 618 (Ind. Ct. App. 1986).

147. 540 N.E.2d at 650. The court did observe in a footnote “that other jurisdictions view the non-custodial parent’s right to visitation and the custodial parent’s right to choose religious training as competing but co-equal interests.” 540 N.E.2d at 650 n.1. See *Wagner v. Wagner*, 165 N.J. Super. 553, 398 A.2d 18 (1979); *Morris v. Morris*, 271 Pa. Super. 19, 412 A.2d 139 (1979).

148. 540 N.E.2d at 650.

IV. MAINTENANCE

Although *Rump v. Rump*¹⁴⁹ adds little, if anything, to existing case law concerning an award of post-decree maintenance, it does reinforce prior authority regarding the factors to be considered in making an award of maintenance.¹⁵⁰ *Rump* also reiterates the established principle that a maintenance award is not mandatory even if the court finds that a spouse's incapacity materially affects his or her self-supportive ability.¹⁵¹

In *Rump*, the trial court found that the wife suffered from osteoarthritis, peripheral neuropathy, lumbar disc protrusion, hypertension, peptic ulcer, and obesity. A physician considered her to have a 15% to 20% permanent partial impairment, and she had been injured in an automobile accident which exacerbated her medical condition. She earned a little over \$70 per week, and had expenses of approximately \$440. Thus, she sought a weekly maintenance award amounting to the difference. On appeal, the wife contended it was error for the trial court to deny her maintenance given the evidence of her physical incapacity and its effect upon her ability to support herself.¹⁵² Relying upon the well-established principle that an award of maintenance is discretionary, the court stated the factors to be considered in making a determination regarding maintenance:

If the spouse's self-supportive ability is materially impaired, the propriety of the maintenance award and the amount thereof should be determined after considering such factors as the financial resources of the party seeking maintenance (including matrimonial property apportioned to that spouse), the standard of living established in the marriage, the duration of the marriage, and the ability of the spouse from whom maintenance is sought to meet his or her needs while meeting those of the spouse seeking maintenance.¹⁵³

The court noted the majority of the marital estate had been awarded to the wife, and she was also a plaintiff in a pending civil action for damages relating to the automobile accident.¹⁵⁴

149. 526 N.E.2d 1045 (Ind. Ct. App. 1988).

150. See *In re Marriage of Dillman*, 478 N.E.2d 86, 87 (Ind. Ct. App. 1985).

151. *Rump*, 526 N.E.2d at 1046 (citing *Coster v. Coster*, 452 N.E.2d 397, 403 (Ind. Ct. App. 1983)).

152. 526 N.E.2d at 1046.

153. *Id.*

154. *Id.*

In *Beeson v. Beeson*,¹⁵⁵ the court confronted a claim for rehabilitative maintenance with a spouse who fell far short of presenting a compelling case for such an award.¹⁵⁶

The husband was a successful plastic surgeon, well educated and possessing superior earning capacity. His wife had a lesser education, earned \$28,000 per year when last employed, and had interrupted her employment during the marriage to care for the parties' children. At the time of the final hearing, however, the wife had been unemployed for only three years, was only thirty-four years old, was in good health, and received over 75% of the marital property. The wife contended on appeal that her husband's high income and her lack of gainful employment made her deserving of spousal maintenance. Disagreeing, the court observed that her request to reverse the trial court on this issue amounted to nothing more than a request to reweigh the evidence.¹⁵⁷

V. RECENT LEGISLATION

A considerable amount of legislation has been passed which will be of interest to any family law practitioner. Legislation which may significantly affect dissolution and post-decree litigation is summarized below.

Indiana Code section 31-1-11.5-13 "Payment of Support Orders," has been amended effective July 1, 1989. The statute now allows a court to order a person to perform community service without compensation if that person is found to be delinquent in the payment of child support as a result of an intentional violation of a support order.¹⁵⁸

Indiana Code section 31-1-11.5-8(d) was added effective July 1, 1989. This section provides that the court may enter a summary dissolution decree without holding a final hearing if verified pleadings are signed by both parties and filed with the court. The pleadings must contain a written waiver of the final hearing, and either a statement

155. 538 N.E.2d 293 (Ind. Ct. App. 1989).

156. See IND. CODE § 31-1-11.5-1(e) (1988).

157. 538 N.E.2d at 298.

158. Section two of P.L. 65-1989 added Subsection (h) to IND. CODE § 31-1-11.5-13 as follows:

(h) If the court finds that a party is delinquent in the payment of child support as a result of an intentional violation of an order for support, the court may find the party in contempt of court. The court may order a party who is found in contempt of court under this subsection to perform community service without compensation in a manner specified by the court.

that there are no contested issues or that a written settlement is filed.¹⁵⁹

In addition to the foregoing amendment, Indiana Code section 31-1-11.5-8 was also amended to provide that, effective July 1, 1989, a court may bifurcate the issues in an action for dissolution of marriage by entering a summary disposition of the uncontested issues and setting the contested issues for trial.¹⁶⁰

Indiana Code section 31-1-11.5-7, pertaining to provisional orders has been amended effective May 3, 1989. It now requires the clerk of a court which issues a temporary restraining order to supply a copy of that order to each party, the county sheriff, and the municipal law enforcement agency in which the protected person resides.¹⁶¹ The sheriff

159. Section one of P.L. 269-1989 added subsection (d) to IND. CODE § 31-1-11.5-8 as follows:

(d) At least sixty (60) days after a petition is filed in an action under section 3(a) of this chapter the court may enter a summary dissolution decree without holding a final hearing under this section if there have been filed with the court verified pleadings, signed by both parties, containing:

- (1) a written waiver of final hearing; and
- (2) either:

- (A) a statement that there are no contested issues in the action; or
- (B) a written agreement made in accordance with section 10 of this chapter that settles any contested issues between the parties.

160. Section one of P.L. 269, 1989 added subsection (e) to IND. CODE § 31-1-11.5-8 as follows:

(e) The court may bifurcate the issues in an action filed under section 3(a) of this chapter to provide for a summary disposition of uncontested issues and a final hearing of contested issues. The court may enter a summary disposition order under this subsection upon the filing with the court of verified pleadings, signed by both parties, containing:

- (1) a written waiver of a final hearing in the matter of:
 - (A) uncontested issues specified in the waiver; or
 - (B) contested issues specified in the waiver upon which the parties have reached an agreement;
- (2) a written agreement made in accordance with section 10 of this chapter pertaining to contested issues settled by the parties; and
- (3) a statement:
 - (A) Specifying contested issues remaining between the parties; and
 - (B) requesting the court to order a final hearing as to contested issues to be held under this section.

The court may include in a summary disposition order entered under this subsection a date for a final hearing of contested issues.

161. Section two of P.L. 53-1989 added subsections (g) and (h) to IND. CODE § 31-1-11.5-7 as follows:

- (g) The clerk of the court that issued an order under subsection (b) (2) or (b) (3) shall provide a copy of the order to:
 - (1) each party;
 - (2) the sheriff; and
 - (3) the law enforcement agency of the municipality (if any) in which the

and law enforcement agencies which receive such an order are required to maintain a depository in which to keep the order for a period of one year unless otherwise specified in the order.¹⁶²

Indiana Code section 31-1-11.5-8.1 was added, effective July 1, 1989. It requires the party who initiates an action for dissolution of marriage and files a motion to dismiss to notify the opposing party. The opposing party, in turn, may file a counter-petition for dissolution of marriage within 5 days after the filing of the motion to dismiss. A final hearing may be held after 60 days after the filing of the initial petition.¹⁶³

The conciliation procedures available under Indiana Code section 31-1-11.5-19 have been amended to provide that referrals may be made to mediators in addition to family service agencies, community mental health centers, clinical psychologists, physicians, attorneys, and clergy.¹⁶⁴

protected person resides.

(h) Each sheriff and law enforcement agency that receives an order under subsection (g) shall maintain a copy of the order in the depositor established under IC 5-2-9. The order may be removed from the depositor after the later of the following:

- (1) The elapse of one (1) year after the order is issued.
- (2) The date specified in the order (if any).

162. IND. CODE § 31-1-11.5-7(n). *See supra* note 152.

163. Section two of P.L. 269-1989 added IND. CODE § 31-1-11.5-8.1 as follows:

Sec. 8.1 (a) This section applies when a party who filed an action under section 3(a) of this chapter files a motion to dismiss the action.

(b) A party that files an action shall serve each other party to the action with a copy of the motion.

(c) A party to the action may file a counter petition under section 3(a) of this chapter no later than five (5) days after the filing of the motion to dismiss. If a party files a counter petition under this subsection, the court shall set the petition for final hearing no earlier than sixty (60) days after the initial petition was filed.

164. Section four of P.L. 269-1989 amended IND. CODE § 31-1-11.5-19 which now reads as follows:

Sec. 19. Any court that is exercising jurisdiction over domestic relation cases may establish a family relations division of the court. The family relations division may be administered by the community mental health center or by any other person approved by the court. The division shall offer counseling and related services to person before the court. Conciliation procedures may include, but shall not be limited to, referrals to the family relations division of the court, if established, public or private marriage counselors, family service agencies, community mental health centers, clinical psychologists, physicians, attorneys, clergy or mediators. The costs of conciliation procedures shall be paid by the parties as the court shall order, unless the court determines that such parties will be unable to pay the costs without prejudicing their financial ability to provide themselves and any minor children with economic necessities, in which such costs shall be paid from the budget of the court.

IND. CODE § 31-1-11.5-19 (1989).

VI. CONCLUSION

During the survey period, significant legislative changes and case law development occurred in the area of dissolution of marriage. The trend toward equal distribution of marital assets continues, as does the trend toward recognizing as marital property valuable property rights heretofore excluded from the marital pot. The advent of presumptively applicable child support guidelines and schedules, together with income verification requirements, should make child support more uniform throughout the state. Legislative changes are directed toward expediting resolution of non-contested issues in divorce, and may have the effect of both relieving crowded dockets and reducing the cost of representation.

Health Law Update: A Survey of Recent Developments in Indiana Law Governing Health Care Providers

J. MICHAEL GRUBBS*

During the survey period significant judicial and legislative developments added to the growing body of Indiana law governing health care providers. Judicial opinions addressed the issues of physician-hospital relations, the physician-patient privilege, and "patient-dumping." The Indiana General Assembly enacted statutes dealing with peer review privilege, access to medical records, and Medicaid provider sanctions for solicitation of out-of-state clients.

I. JUDICIAL OPINIONS

A. Hospital Bylaw Provisions and Due Process

In *Friedman v. Memorial Hospital of South Bend*,¹ the court of appeals addressed the standard of review Indiana courts will apply in breach of contract cases based on a hospital's alleged lack of compliance with its bylaw provisions governing physician disciplinary hearing procedures. The case involved an appeal from a summary judgment entered in favor of the defendant hospital in an action brought by a physician who had been disciplined by the hospital.

Friedman's surgical performance had been the subject of two disciplinary hearings conducted by the Executive Committee of the hospital's Board of Directors which was acting in the capacity of a peer review committee. In the trial court Friedman first alleged that he had been denied due process of law because the hospital failed to notify him of the charges against him prior to the first hearing. The court of appeals noted that the trial court's finding that due process had been provided by the hospital was "irrelevant" because "absent some state action, the due process rights found within the fifth and fourteenth amendments are inapplicable" to private institutions.²

Based on prior appellate court decisions holding that medical staff bylaws create a contract between a hospital and its medical staff,³ the

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1. 523 N.E.2d 252 (Ind. Ct. App. 1988).

2. *Id.* at 253 (citing *Pepple v. Parkview Memorial Hosp., Inc.*, 511 N.E.2d 467, 469 (Ind. Ct. App. 1987)).

3. *Terre Haute Regional Hosp., Inc. v. El-Issa*, 470 N.E.2d 1371 (Ind. Ct. App. 1984).

court of appeals confined its review to a provision in the hospital bylaws which were in effect at the time of the first disciplinary hearing. The bylaws stated that a practitioner requesting a hearing is entitled to notice of the "scheduled place, time, and date" of the hearing but did not require that the physician be notified of the pending changes.⁴ The court found that the hospital had complied with its bylaws, because the bylaws did not literally require the hospital to notify the physician of the charges which were the basis for a hearing, although the court noted that "the better practice would be for the notice to contain such information."⁵

Prior to the second hearing, the hospital modified the bylaws by adding a provision which required that prior to a hearing the practitioner must be notified of the "alleged acts or omissions" in a notice containing "a list by number of the specific or representative patient records in question . . ."⁶ The notice of the second hearing sent to Friedman listed the patients by name rather than by number. In response to Friedman's claim that a breach of contract occurred because the hospital failed to comply with this bylaw provision, the court held that "[w]hile we agree that the notice failed to strictly comply with the by-laws in this regard, the standard is one of substantial compliance."⁷ The court found that the hospital had substantially complied with its bylaws because the patient names supplied in lieu of record numbers permitted the physician to obtain and review the records of the cases which were the subject of the charges to be discussed at the hearing. Therefore, the court found the minor deviation from the bylaws caused no harm to the physician.

The articulation of a substantial compliance standard by the court appears to grant flexibility to hospitals in applying procedures established under their bylaws. The opinion also implies that the degree of flexibility will vary with each provision. The court's reliance on the lack of harm in selecting a substantial compliance standard in this case implies that in other cases strict compliance with hospital bylaw provisions involving physician discipline will be required if a physician can show harm was caused by even a minor deviation.

Another decision during the survey period involving a hospital-physician disciplinary action was *Pepple v. Parkview Memorial Hospital, Inc.*,⁸ the third judicial opinion arising from a 1982 decision by a hospital

4. *Friedman*, 523 N.E.2d at 253.

5. *Id.*

6. *Id.*

7. *Id.* at 254 (citing *Terre Haute Regional Hosp., Inc. v. El-Issa*, 470 N.E.2d 1371 (Ind. Ct. App. 1984)).

8. 536 N.E.2d 274 (Ind. 1989).

board of directors to limit the surgical privileges of one of its physicians.⁹ In this opinion, the Indiana Supreme Court overruled in part an earlier court of appeals decision, *Kennedy v. St. Joseph Memorial Hospital*,¹⁰ which permitted review of a private hospital's action under an arbitrary and capricious standard.¹¹

The *Pepple* court held that, although the distinction between public and private hospitals has been "blurred by the influx of governmental funds and concerns for the public interest," private conduct is not subject to scrutiny under the fourteenth amendment's Due Process Clause "no matter how unfair that conduct may be."¹² The court held that the test is "whether there is a sufficiently close nexus between the State and the challenged action of the regulated entity that the action of the latter may fairly be treated as that of the State itself."¹³

In a footnote, the court noted with approval that Judge Ratliff's concurring opinion in *Kiracofe v. Reid Memorial Hospital*¹⁴ discusses the evidence necessary to establish the nexus required to establish the presence of state action. The court found no state action in this case because no evidence had been offered to attempt to establish that the hospital's restriction of a licensed physician's surgical privileges constituted an act of the state.

B. Limits on Abrogation of the Physician-Patient Privilege Under Child Abuse Reporting Statutes

In *Daymude v. State*,¹⁵ a local welfare department learned of an instance of suspected child abuse and filed a "child in need of services" petition¹⁶ which resulted in court-ordered admission of the child to an

9. Parkview Memorial Hosp., Inc. v. Pepple, 483 N.E.2d 469 (Ind. Ct. App. 1985) (peer review proceedings conducted by an *ad hoc* committee of physicians and the executive committee of the board of directors are subject to the confidentiality and privilege provisions of IND. CODE § 34-4-12.6-2 in general civil actions as well as medical malpractice actions); Pepple v. Parkview Memorial Hosp., Inc., 511 N.E.2d 467 (Ind. Ct. App. 1987) (due process clause does not apply to action between private hospital and physician).

10. 482 N.E.2d 268 (Ind. Ct. App. 1985).

11. *Pepple*, 536 N.E.2d at 276.

12. *Id.* (quoting from Justice Stephens' opinion in *National Collegiate Athletic Association v. Tarkanian*, 109 S. Ct. 454, 461 (1988)).

13. *Id.* (citing *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345 (1974)). The court also affirmed a prior Court of Appeals decision in *Terre Haute Regional Hosp., Inc. v. El-Issa*, 470 N.E.2d 1371 (Ind. Ct. App. 1984), holding that hospital staff bylaws can constitute a contract between a hospital and its staff. However, no breach of that contract was found in this case because all procedural rights provided in the bylaws were afforded to the physician.

14. 461 N.E.2d 1134, 1141-44 (Ind. Ct. App. 1984).

15. 540 N.E.2d 1263 (Ind. Ct. App. 1989).

16. IND. CODE § 31-6-4-10 (1988).

in-patient facility and the court-ordered counseling of the alleged victim, the alleged victim's mother, and the father of the alleged victim. During the course of a counseling session, the father disclosed instances of alleged sexual abuse of his child.¹⁷

Based on information unrelated to the disclosures to the counselor, the father was charged with child molesting,¹⁸ criminal deviate conduct,¹⁹ and incest.²⁰ The prosecutor sought to depose the counselor as to the content of communications made to the counselor by the alleged abuser.²¹ In an opinion authored by Judge Baker,²² the Court of Appeals for the First District reversed the circuit court, which had required the counselor to answer questions relating to the privileged confidential communications.

Although the case discusses the physician-patient privilege as it relates to the child abuse reporting statutes, the counselor was not a physician. The counselor was a certified clinical mental health counselor under contract with the hospital who counseled the father pursuant to a referral by the hospital's chief psychiatrist.²³ Turning to the issue whether the child abuse reporting statutes abrogate the physician-patient privilege, the court noted that the physician-patient privilege cannot be waived except by the patient.²⁴ Indiana Code section 34-1-14-5 provides in part that: "The following persons shall not be competent witnesses. . . . Physicians, as to matter communicated to them, as such, by patients, in the course of their professional business, or advice given in such cases, except as provided in IC 9-4-4.5-7."²⁵

This privilege is in conflict with the child abuse reporting statute which provides that "*any individual* who has reason to believe that a child is a victim of child abuse or neglect shall make a report as required by statute."²⁶ In order to resolve the conflict, the legislature enacted Indiana Code section 31-6-11-8 which specifically abrogates certain legally recognized privileges when reporting child abuse. That provision states:

17. 540 N.E.2d at 1264.

18. IND. CODE § 36-42-4-2 (1988).

19. *Id.* § 36-42-4-3.

20. *Id.* § 35-26-1-3.

21. 540 N.E.2d at 1264.

22. *Id.*

23. *Id.*

24. *Id.* at 1264-65.

25. IND. CODE § 34-1-14-5 (1988). *Id.* § 9-4-4.5-7 (1988) was repealed and replaced by IND. CODE ANN. § 9-11-4-6 (West Supp. 1989), which abrogates the privilege in cases involving chemical tests in criminal investigations under Title 9. IND. CODE ANN. § 34-1-14-5 (West Supp. 1989) was accordingly revised for corrective changes. Pub. L. No. 3-1989, Sec. 208, 1989 Ind. Acts 219.

26. IND. CODE § 31-6-11-3 (1988) (emphasis added).

The privileged communication between a husband and wife, between a health care provider and that health care provider's patient, or between a school counselor and a student is not a ground for:

- (1) excluding evidence in any judicial proceeding resulting from a report of a child who may be a victim of child abuse or neglect, or relating to the subject matter of such a report; or

- (2) failing to report as required by this chapter.²⁷

In a case of first impression, the *Daymude* court held that:

The privileged communications were made long after the report of the child abuse. Since the abuse already had been reported, the purpose of the reporting statute had been fulfilled. To allow the abrogation of the privileged communication under these specific facts goes beyond the purpose of the statute.²⁸

The court held that disclosures subsequent to the initial report of child abuse were privileged and not abrogated by the statute because the specific language of the child abuse reporting statute only deals with the duty to *report* suspected child abuse and the admissibility of evidence so obtained.²⁹

C. "Patient-Dumping"

During the survey period, an Indiana court was called upon to interpret a relatively new federal statute which imposes a duty upon most hospitals to treat certain types of patients. The Consolidated Omnibus Reconciliation Act of 1986³⁰ ("COBRA") represents the most recent federal attempt to address a phenomenon known as "patient dumping," which is defined by some commentators as "the transfer of unstable patients or refusal to render emergency treatment to patients based on grounds unrelated to need or the hospital's ability to provide services," or "the refusal of a hospital to provide necessary treatment to an emergency patient or woman in active labor on a basis (primarily the inability to pay for services) unrelated to the hospital's capability to provide care or the patient's need for care."³¹ COBRA's anti-dumping

27. *Id.* § 31-6-11-8.

28. *Daymude v. State*, 540 N.E.2d 1263, 1268 (Ind. Ct. App. 1989).

29. *Id.*

30. Pub. L. No. 99-272, § 921, 100 Stat. 164 (1986) (codified at 42 U.S.C. 1395dd (1986)).

31. Patient Dumping After COBRA: Assessing the Incidence and the Perspectives of Health Care Professionals, Medicare & Medicaid Guide (CCH) ¶¶ 37,436, 37,580 (Aug. 1988).

provisions, which are codified at 42 U.S.C. § 1395dd ("section 1395dd"), affect any hospital which participates in the Medicare program regardless whether the patient is a Medicare beneficiary.³²

1. *Duties Imposed by COBRA.*—Under section 1395dd, if an individual goes to an emergency department and requests an examination or treatment, the hospital must "provide for an appropriate medical screening examination" to determine whether an emergency medical condition or active labor exists.³³ The hospital's obligation to "provide for" a medical screening examination is arguably met if, regardless of the patient's ability to pay, the hospital makes its facilities and personnel available to an emergency room physician in order that the physician may actually provide the examination.³⁴

An emergency medical condition is defined as a condition which manifests:

- [A]cute symptoms of sufficient severity (including severe pain) such that the absence of immediate medical attention could reasonably be expected to result in -
(A) placing the patient's health in serious jeopardy,
(B) serious impairment to bodily functions, or
(C) serious dysfunction of any bodily organ or part.³⁵

Active labor is present when delivery is "imminent," a safe transfer to another hospital cannot be effected prior to delivery, or a transfer "may pose a threat" to the health and safety of the mother or child.³⁶ If the medical screening examination reveals that an emergency medical condition or active labor is not present, the patient may be transferred without violating the statute.³⁷

If, however, during the course of the medical screening examination the physician determines that an emergency medical condition or active labor exists, the hospital must either "provide for" stabilizing treatment or an appropriate transfer.³⁸ The amount of treatment which must be provided by the physician in order to "stabilize" the patient is defined as "such medical treatment of the condition as may be necessary to assure, within reasonable medical probability, that no material deteri-

32. 42 U.S.C. § 1395dd(a)(e)(3) (Supp. V. 1988).

33. *Id.* § 1395dd(a).

34. *Id.*

35. *Id.* § 1395dd(e)(1).

36. *Id.* § 1395dd(e)(2).

37. *Id.*

38. *Id.* § 1395dd(b)(1); *see also id.* § 1395dd(e)(1) (emergency medical condition defined), 1395dd(e)(4) (stabilize defined), 1395dd(c)(2) (appropriate transfer defined).

oration of the condition is likely to result from the transfer of the individual from a facility.”³⁹

Once the patient’s emergency medical condition or active labor is stabilized within the meaning of the statute, the patient may be transferred without violating section 1395dd. A transfer is defined as “the movement (including the discharge) of a patient outside a hospital’s facilities at the direction of any person employed by (or affiliated or associated, directly or indirectly, with) the hospital . . .”⁴⁰ This definition is broad enough to permit a hospital to discharge a stabilized patient without effecting a transfer to another medical facility.

Patients who are in active labor and patients with emergency medical conditions who are not stabilized or cannot be stabilized with the resources available at the hospital may not be discharged and may only be transferred under certain conditions specified in section 1395dd. Such patients may be transferred if the patient or a legally responsible person acting on behalf of the patient requests a transfer.⁴¹ These patients may also be transferred if the physician determines that “based upon the information available at the time, the medical benefits reasonably expected from the provision of appropriate medical treatment at another medical facility outweigh the increased risks to the individual’s medical condition from effecting the transfer . . .”⁴² Even if the physician determines that the benefits of transfer outweigh the risks of transfer, a written certification to that effect must be recorded in the patient’s chart and an “appropriate transfer” must be arranged.⁴³

The elements of an appropriate transfer specify that the receiving hospital must be contacted prior to the transfer to verify that the receiving hospital will agree to accept the patient and provide appropriate treatment, the medical records of the transferring hospital must be sent to the receiving hospital, and the transfer must be effected by using qualified transportation equipment staffed by personnel qualified to provide any life support procedures which may be “required” or “medically appropriate” during the transfer.⁴⁴

Violations can result in suspension or termination of the hospital’s Medicare provider agreement and civil money penalties levied against

39. *Id.* § 1395dd(e)(4)(A).

40. *Id.* § 1395dd(e)(5).

41. *Id.* § 1395dd(c)(1)(A)(i).

42. *Id.* § 1395dd(c)(1)(A)(ii). If a physician is not “readily available” in the emergency department, other “qualified medical personnel” may make the necessary certification and arrange for an appropriate transfer. *Id.*

43. *Id.*; see also *id.* § 1395dd(c)(1)(B).

44. Patient Dumping After COBRA: Assessing the Incidence and the Perspectives of Health Care Professionals, Medicare & Medicaid Guide ¶ 37,436 (Aug. 1988).

the hospital.⁴⁵ A hospital's knowing and willful or negligent violation of any of the provisions of Section 1395dd can result in suspension or termination, while only knowing violations can support a civil money penalty.

Certain physicians who are classified as "responsible physicians" are also subject to exclusion from Medicare participation and civil money penalties. A "responsible physician" is defined as a physician who:

- (i) is employed by, or under contract with, the participating hospital, and
- (ii) acting as such an employee or under such a contract, has professional responsibility for the provision of examinations or treatments for the individual, or transfers of the individual, with respect to which the violation occurred.⁴⁶

Responsible physicians are only subject to exclusion from Medicare or civil money penalties for knowing violations of section 1395dd.⁴⁷

In addition to the administrative sanctions of suspension, termination and fines, civil suits by individuals are provided for in section 1395dd(d)(3)(A), which states:

PERSONAL HARM. Any individual who suffers personal harm as a direct result of a participating hospital's violation of . . . [this statute] may, in a civil action against the . . . hospital, obtain those damages available for personal injury under the law of the State in which the hospital is located, and such equitable relief as is appropriate.⁴⁸

Section 1395dd contains an additional civil enforcement provision available to a "medical facility." Section 1395dd(d)(3)(B) provides:

FINANCIAL LOSS TO OTHER MEDICAL FACILITY. Any medical facility that suffers a financial loss as a direct result of a participating hospital's violation of a requirement of this section may, in a civil action against the participating hospital, obtain those damages available for financial loss, under the law of the State in

45. 42 U.S.C.A. § 1395dd(d) (West Supp. 1989).

46. *Id.* § 1395dd(d)(2)(C).

47. *Id.* 42 U.S.C.A. § 1395dd(d)(2)(B) permits the assessment of civil money penalties for knowing violations and 42 U.S.C.A. § 1395dd(d)(1) permits exclusion of physicians under 42 U.S.C. § 1395u(j)(2)(A) (Supp. V. 1988) only "[i]f a civil money penalty is imposed." The statute's definition of "responsible physicians" seems to include non-treating physicians who "have professional responsibility for" providing examinations or treatments. 42 U.S.C.A. § 1395dd(d)(2)(C) (West Supp. 1989).

48. 42 U.S.C.A. § 1395dd(d)(3)(A) (West Supp. 1989) (emphasis added).

which the hospital is located, and such equitable relief as is appropriate.⁴⁹

Therefore, a hospital that is "dumped on" may bring a civil action for monetary damages.

The relationship between the duties imposed by COBRA's anti-dumping provisions on hospitals which participate in Medicare to the duties which are already imposed on all hospitals and physicians under State laws is set out at section 1395dd(f), which states:

PREEMPTION. The provisions of this section do not preempt any State or local law requirement, except to the extent that the requirement *directly conflicts* with a requirement of this section.⁵⁰ (Emphasis added.)

2. *COBRA and the Indiana Medical Malpractice Act.*—During the survey period, the third reported case in the nation involving section 1395dd, *Reid v. Indianapolis Osteopathic Medical Hospital*,⁵¹ was decided here in Indiana. In *Reid*, the plaintiff's wife was seriously injured in an automobile accident and was transported to the emergency room at the defendant hospital. After initial treatment, arrangements were made to transfer her to another hospital where she later died.⁵²

Instead of filing a proposed complaint of malpractice, plaintiff filed suit in federal court claiming that the defendant hospital had violated section 1395dd because it failed to provide "appropriate medical care" for his wife, failed to provide her with "necessary stabilizing treatment," and had transferred her in an unstable condition.⁵³ The defendant hospital moved to dismiss the complaint asserting that the plaintiff's allegations fell within the scope of the Indiana Medical Malpractice Act ("Act"). The hospital argued that the case should be dismissed because the plaintiff had not yet filed a proposed complaint with the Indiana Department of Insurance as required by the Act.⁵⁴ Although the court denied the defendant hospital's motion to dismiss, the opinion authored by Judge Barker went beyond the procedural issues to consider whether the Act's

49. *Id.* § 1395dd(d)(3)(B).

50. 42 U.S.C. § 1395dd(f) (Supp. V 1988).

51. 709 F. Supp. 853 (S.D. Ind. 1989). The first reported cases were *Bryant v. Riddle Memorial Hosp.*, 689 F. Supp. 490 (E.D. Pa. 1988) (section 1395dd creates a federal cause of action that can be pursued in federal courts), and *Maziarka v. St. Elizabeth Hosp.*, [New Developments] Medicare & Medicaid Guide (CCH) ¶ 38,010 (E.D. Ill. 1989). Several administrative enforcement actions are also in process. See *Inspector General v. Burditt*, [New Developments] Medicare & Medicaid Guide (CCH) ¶ 38,027 (July 28, 1989).

52. *Reid*, 709 F. Supp. at 853.

53. *Id.*

54. *Id.* at 854.

cap on damages applies to section 1395dd claims and the "standard of care" in such cases.

The court refused to accept the defendant's argument that Indiana's procedural limitations on medical malpractice actions create a bar to federal court jurisdiction under section 1395dd.⁵⁵ The court found that even if Congress had intended to incorporate state limitations on patient dumping claims, Section 1395dd would still preempt the medical review panel procedures of the Indiana Act because of a "direct conflict" between them as to when a cause of action arises.⁵⁶ The Act provides that no cause of action arises until after the medical review panel renders an opinion, whereas the anti-dumping statute provides a cause of action arises whenever "[a]ny individual . . . suffers personal harm as a direct result of a participating hospital's violation of a requirement of this section. . . ."⁵⁷

Although no further comment was required to dispose of the defendant hospital's motion to dismiss for lack of subject matter jurisdiction, the court found another area of conflict when it stated that section 1395dd is "based on a strict liability standard."⁵⁸ The court reasoned that even if a medical review panel "were permitted to screen" complaints alleging violations of section 1395dd prior to commencing an action in federal court, a medical review panel's negligence determination "would, at best, be totally irrelevant . . . [and] [a]t worst . . . 'directly conflict' with the strict liability standards of the federal statute."⁵⁹ Presumably, if a plaintiff chooses to file both a civil enforcement suit in federal or state court based on an alleged violation of Section 1395dd *and* a complaint with the Department of Insurance for alleged medical malpractice arising from the same facts, then this dicta suggests that the opinion of the medical review panel would either be irrelevant to the section 1395dd issue or be preempted by the same.

Despite the procedural conflicts found by the court, the court found no barrier which prevented the application of the Act's cap on damages to section 1395dd civil enforcement suits. Plaintiff argued that section

55. *Id.* at 854 n.1 (citing *Bryant v. Riddle Memorial Hosp.*, 689 F. Supp. 490 (E.D. Pa. 1988)).

56. *Id.* at 854-55.

57. 42 U.S.C. 1395dd(d)(3)(A) (Supp. V 1988).

58. *Reid*, 709 F. Supp. at 855. It is unclear from the opinion whether the defendant hospital conceded that strict liability is the "standard" to be applied under section 1395dd. In response to the defendant hospital's motion to dismiss, the plaintiff argued that the Indiana Medical Malpractice Act is preempted by the federal statute because of a "direct conflict" between the two acts. Plaintiff's perceived conflict was based on his interpretation that section 1395dd employs a strict liability standard which "directly conflicts" with the negligence standard applied under the Act.

59. *Id.*

1395dd(d)(3)(A)'s reference to "those damages available for personal injury" should not be read as "those damages available for personal injury [due to medical malpractice]"⁶⁰ and therefore the Act's cap on the *amount* of damages recoverable in an action for medical malpractice does not apply to a civil enforcement suit under section 1395dd.⁶¹

The court stated that the legislative history of section 1395dd was "completely silent" as to whether Congress intended state medical malpractice caps to apply to a civil enforcement suit under section 1395dd.⁶² The court, however, relied on the legislative history of section 1395dd for the proposition that because Congress was "clearly aware of a growing concern in some states that excessive damage awards were fueling a medical malpractice 'crisis,'" Congress "apparently wished to preserve" state medical malpractice caps by choosing to incorporate "those damages available for personal injury under the law of the state" when it enacted Section 1395dd.⁶³ The court also noted that it was unaware of any state which had limited the amount of damages recoverable in personal injury suits other than medical malpractice actions.⁶⁴ The court concluded that unless section 1395dd was read to incorporate the Act's cap on the amount of damages, the phrase "those damages available for personal injury under the law of the state" would be rendered meaningless.⁶⁵

The court construed the reference in section 1395dd to "those damages" to refer to the "amount" of damages recoverable.⁶⁶ It then held that a civil enforcement suit under section 1395dd seeking damages for personal injury is subject to the Act's "substantive limitation on the maximum amount recoverable for personal injury from a health care provider"⁶⁷ because "the amount of damages that would be 'available' for a personal injury claim against a health care provider would be *only* those damages available under [the] medical malpractice statute itself."⁶⁸

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.* at 856. The court ordered that "all future action in this case relating to the measure of plaintiff's damages under the Act, if any, shall be subject to the analysis and holding in this entry." (emphasis added). *Id.*

68. *Id.* at 855 (emphasis in original). The Act limits civil damages in actions against "qualified" health care providers to \$100,000. IND. CODE § 16-9.5-2-2(b) (1988). A "qualified" provider is one who files proof of malpractice insurance coverage with the Department of Insurance. *Id.* § 16-9.5-2-1. Plaintiffs who recover the maximum civil damage award may file a claim for additional damages up to \$400,000 against the Patient's Compensation Fund. *Id.* § 16-9.5-2-2(d).

3. *Implications of Reid.*—The court's opinion in *Reid* will undoubtedly be of great concern to hospitals and their counsel who desire to ensure that hospital emergency room triage and transfer procedures do not run afoul of the anti-dumping statute. Despite the fact that the discussion of strict liability as the proper "standard" to be applied is merely dicta because the opinion was limited to a ruling on the defendant hospital's motion to dismiss, the court implied that strict liability is a "standard" to be applied in civil suits arising under section 1395dd.

A strict liability statute is defined as a statute "which imposes criminal sanction for an unlawful act without requiring a showing of criminal intent."⁶⁹ Under section 1395dd's administrative enforcement provisions, intent must be shown because the termination/suspension sanctions may only be imposed on a hospital which "knowingly and willfully, or negligently" violates the statute⁷⁰ and the civil money penalty sanctions may be levied only if a hospital "knowingly violates" the statute.⁷¹ The "knowingly and willfully, or negligent" element precludes the ultimate penalty of termination or suspension of a hospital's Medicare provider agreement unless the administrative agency can prove either that the statute was violated with criminal intent or that the duties imposed by the statute were breached. A breach may occur, for example, where the medical screening examination which was provided was not appropriate or the treatment provided was not sufficient to stabilize the patient before the patient was transferred. The lesser sanction of civil fines can be imposed if the duties imposed by the statute were unintentionally breached.

The administrative enforcement provisions of the statute are clearly not part of a strict liability statutory scheme because Congress provided that administrative agencies must meet the burden of showing that a violation of section 1395dd was either an intentional or negligent act in order to impose an administrative sanction. The only difference between the civil enforcement provision and the administrative enforcement provisions is that the civil enforcement provision contains no reference to either criminal intent or negligence. It is presumably the omission of this language which caused the court in *Reid* to label the civil enforcement provision a strict liability provision.

The omission of language regarding the intent of a physician or hospital to violate the provisions of section 1395dd or language regarding the applicable standard of care has been cited by at least one commentator as the basis for using statutory construction principles to conclude that

69. BLACK'S LAW DICTIONARY 1275 (5th ed. 1979).

70. 42 U.S.C.A. § 1395dd(d)(1) (West Supp. 1988).

71. *Id.* § 1395dd(d)(2)(A).

Congress intended that strict liability apply in civil enforcement cases.⁷² Section 1395dd does not, however, change the standard of care applicable to certain physicians and hospitals merely because they participate in the Medicare program. Strict liability is not a standard of care; it is a theory of liability imposed on sellers of defective or hazardous products.⁷³ Liability for the provision of substandard care and treatment to emergency room patients by *any* physician or hospital is governed by common-law negligence and statutory medical malpractice concepts regardless of whether the physician or hospital participates in the Medicare program.

Section 1395dd merely creates some duties which previously were not imposed on physicians and hospitals which participate in Medicare. Whereas before the enactment of section 1395dd participating hospitals were under no duty to treat all patients, section 1395dd now requires that two classes of persons be treated: women in active labor and persons with emergency medical conditions.⁷⁴ Once the person has been accepted for a medical screening examination or treatment, section 1395dd actually imposes few duties that are not already imposed on all hospitals. After the enactment of section 1395dd, medical screening examinations must now be provided upon the request of any person who comes to the emergency department of a participating hospital.⁷⁵ Transfers and discharges of certain patients can only be made after a physician either treats the patient or documents the reasons for deciding on transfer or discharge.⁷⁶ The written reasons must include an assessment of the risks of transfer versus the benefits of treatment elsewhere.⁷⁷ Hospitals must get receiving hospitals to agree to accept patients and records must be sent with the patient.⁷⁸

Apart from the new duties imposed on some physicians and hospitals, section 1395dd does not change the standard of care against which all hospitals and physicians are judged when treating patients who are accepted for treatment. Questions such as whether a hospital provided for, or whether a physician performed, "an appropriate medical screening;"⁷⁹ whether in the course of performing such a screening a physician failed to detect the presence of an "emergency medical condition" or "active labor,"⁸⁰ whether a hospital provided for and a physician per-

72. McClurg, *Your Money or Your Life: Interpreting The Federal Act Against Patient Dumping*, 24 WAKE FOREST L. REV. 173, 208 (1989).

73. BLACK'S LAW DICTIONARY 1275 (5th ed. 1979).

74. 42 U.S.C. § 1395dd(b)(1) (Supp. V 1988).

75. *Id.* § 1395dd(a).

76. *Id.* § 1395dd(b)(1).

77. *Id.* § 1395dd(c)(1)(A)(ii).

78. *Id.* § 1395dd(c)(2).

79. *Id.* § 1395dd(a).

80. *Id.* § 1395dd(e)(1)-(2).

formed a "medical examination and such treatment as may be required to stabilize the medical condition or to provide for treatment of the labor;"⁸¹ and whether a physician properly certified that "the medical benefits reasonably expected from provision of appropriate medical treatment at another medical facility outweigh the increased risks to the individual's medical condition from effecting the transfer,"⁸² can only be answered by expert testimony as to what a reasonable physician or hospital would have done under the same or similar circumstances. If expert testimony establishes that the physician or hospital provided sub-standard care and treatment, the duty to provide care and treatment in accordance with the standard of care has been breached.⁸³ If that breach was a proximate cause of the plaintiff's injuries, the plaintiff has a claim under either state medical malpractice statutes, section 1395dd, or both, depending on the source of the underlying duty.

If section 1395dd is viewed as simply creating new duties, breaches of which can only be proved by expert testimony as to the standard of care applicable to hospitals and physicians, the civil enforcement provision merely creates a negligence *per se* theory of liability.⁸⁴ A negligence *per se* theory is consistent with the court's holding that "the amount of damages that would be 'available' for a personal injury claim against a health care provider would be *only* those damages available under [the] medical malpractice statute itself."⁸⁵ The Act defines "malpractice" as a "tort or breach of contract based on health care or professional services rendered, or which should have been rendered, by a health care provider, to a patient."⁸⁶ The Act defines "tort" as "any legal wrong, breach of duty, or negligent or unlawful act or omission proximately causing injury or damage to another."⁸⁷ This definition is broad enough to encompass intentional or negligent violations of federal statutory provisions such as Section 1395dd.

The recent Illinois case of *Maziarka v. St. Elizabeth Hospital*⁸⁸ illustrates how another court interpreted that state medical malpractice law and section 1395dd were intended to be applied together. In *Maziarka* the plaintiff sought actual damages, an injunction requiring the hospital

81. *Id.* § 1395dd(b)(1)(A).

82. *Id.* § 1395dd(c)(1)(A)(ii).

83. See Inspector General v. Burditt, [New Developments] Medicare & Medicaid Guide (CCH) ¶ 35,027 (July 28, 1989).

84. See McClurg, *supra* note 70, at 209-10.

85. Reid v. Indianapolis Osteopathic Medical Hosp., Inc., 709 F. Supp. 853, 855 (S.D. Ind. 1989) (emphasis in original).

86. IND. CODE § 16-9.5-1-1(h) (1988).

87. *Id.* § 16-9.5-1-1(g).

88. [New Developments] Medicare & Medicaid Guide (CCH) ¶ 38,010 (E.D. Ill. 1989).

to comply with Section 1395dd, and punitive damages.⁸⁹ The *Maziarka* court found that Illinois law does not permit the recovery of punitive damages in medical malpractice cases.⁹⁰ The court dismissed plaintiff's claim for punitive damages despite plaintiff's assertion that the action was not a malpractice claim but rather a claim "for a violation of a statute which provides its own basis for relief."⁹¹ The court ruled that "the only claim plaintiff could have against defendants under the law of Illinois is for medical malpractice. . . ."⁹²

The holding in *Maziarka* illustrates that a civil enforcement suit under section 1395dd is a species of medical malpractice. It also provides additional insight into the interpretation of the phrase "those damages available under the personal injury law of the state." The *Reid* court interpreted "those damages" to refer to the *amount* of damages which are recoverable.⁹³ The *Maziarka* court found that "those damages" also refers to the *type or character* of damages, e.g., punitive damages, consequential damages, etc.⁹⁴ The opinions in *Reid* and *Maziarka* both recognize that Congress clearly intended for state and federal courts to look to the medical malpractice law of the state to supply the answers to such questions as whether state malpractice caps apply and what types of damages are recoverable.

The relationship between section 1395dd and the Indiana Medical Malpractice Act raises an interesting dilemma for both plaintiffs and courts in *Reid* and its progeny. The plaintiff in *Reid* will clearly be limited to a maximum recovery of \$100,000 if a trial on the merits finds that a breach of the duties imposed by Section 1395dd was the proximate cause of his wife's damages. A subsequent claim against the Patient Compensation Fund will be barred by the Act,⁹⁵ however, because no complaint has been filed with the Department of Insurance.

On the other hand, if the plaintiff in *Reid* had also filed a proposed complaint with the Department of Insurance alleging medical malpractice arising from the acts which led to his wife's death, the two year statute of limitations applicable to Section 1395dd would have been tolled and the plaintiff could have ultimately recovered damages of up to \$500,000. Although the *Reid* court has analyzed section 1395dd(d)(3)(A) as a strict

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Reid v. Indianapolis Osteopathic Medical Hosp., Inc.*, 709 F. Supp. 853 (S.D. Ind. 1989).

94. *Maziarka*, [New Developments] Medicare & Medicaid Guide (CCH) ¶ 38,010 (E.D. Ill. 1989).

95. IND. CODE § 16-9.5-1-1 (1988).

liability statute which renders the expert testimony of a medical review panel as "irrelevant," a panel could clearly render an opinion as to whether the statutory duties have been breached. This opinion would be as relevant as the opinion of any other expert. While the filing of a proposed complaint with the Department of Insurance is clearly not required after *Reid*, no direct conflict with section 1395dd is created by filing claims in either state or federal court *and* with the Department of Insurance.

Although "patient dumping" is a new and unfamiliar territory for Indiana courts, practitioners involved in future proceedings should carefully examine the relationship between Section 1395dd and the Indiana Medical Malpractice Act in order to fill the gaps left open by Congress.

II. LEGISLATIVE DEVELOPMENTS

A. *Peer Review Legislation*

Public Law 292-1989 (Senate Enrolled Act ("SEA") 240)⁹⁶ extends the applicability of the Indiana Peer Review Statute and also permits the Attorney General to obtain records of privileged communications in certain circumstances.

Section 1 of SEA 240 adds community mental health centers and private psychiatric hospitals to the list of "professional health care providers and organizations" covered by the Act.⁹⁷ A "peer review committee" covered by the Act now also specifically includes committees organized by the governing board of a hospital or professional health care organization, a hospital medical staff, or a governing board of a preferred provider organization or prepaid health care delivery plan.⁹⁸

The scope of privileged communications is also broadened by expansion of the definition of "evaluation of patient care" to include a peer review committee's assessment of "quality" care.⁹⁹

Section 2 provides that waivers of the evidentiary privilege may now be executed on behalf of the peer review committee in favor of the Attorney General for the purpose of conducting an investigation under Indiana Code section 25-1-7, provided that the information so released must be kept confidential except to the extent that the information is otherwise discoverable from original sources such as personal knowledge

96. 1989 Ind. Acts 2008 (codified at IND. CODE ANN. § 34-4-12.6 (West Supp. 1989)).

97. IND. CODE ANN. § 34-4-12.6-1 (West Supp. 1989).

98. *Id.* § 34-4-12.6-1(c)(1). This statute codifies the Court of Appeals holding in Parkview Memorial Hosp., Inc. v. Pepple, 483 N.E.2d 469 (Ind. Ct. App. 1985).

99. IND. CODE ANN. § 34-4-12.6-1(b)(2) (West Supp. 1989).

of a committee member or one who has testified before the committee.¹⁰⁰ This section also provides for the issuance of subpoenas by the Attorney General to obtain applications for staff privileges or applications for employment completed by professional staff members, incident reports documenting the circumstances of "an accident or unusual occurrence involving a professional staff member" which are not prepared as part of a peer review committee investigation, and information otherwise discoverable from original sources.¹⁰¹

Section 3 now enumerates the "legitimate internal business purposes" for which information obtained by the committee may be used, including: quality review and assessment; utilization review and management; risk management and incident reporting; safety, prevention, and correction; reduction of morbidity and mortality; scientific, statistical, and educational purposes, and; legal defense.¹⁰²

The exception to the peer review privilege providing for investigations by the Attorney General under Indiana Code section 25-1-7 and for the legal defense of the hospital constitute a new limit on a privilege which courts have traditionally held to be absolute. In *Terre Haute Regional Hospital v. Badsen*,¹⁰³ the court of appeals refused to impose any limitations on the privilege when it ruled that even communications made in bad faith are privileged under the statute. The court reasoned that access to such information would derogate the quality of the peer review process which is designed to:

[f]oster an effective review of medical care. An effective review requires that all participants to a peer review proceeding communicate candidly, objectively, and conscientiously. Absent the protection of a privilege, the candor and objectivity of peer review communications and the effectiveness of the peer review process would be hindered. Thus, the peer review privilege provides protection by granting confidentiality to all communications, proceedings, and determinations connected with a peer review process.¹⁰⁴

It remains to be seen whether the newly created exceptions to the peer review privilege will inhibit the candor and objectivity of peer review communications.

100. *Id.* § 34-4-12.6-2(j).

101. *Id.* § 34-4-12.6-2(k).

102. *Id.* § 34-4-12.6-4.

103. 524 N.E.2d 1306 (Ind. Ct. App. 1988).

104. *Id.* at 1311. This holding by the First District of the Court of Appeals was followed by the Third District in *Frank v. Trustees of Orange County Hosp.*, 530 N.E.2d 135 (Ind. Ct. App. 1988).

B. Release of Medical Records

Public Law 291-1989 (Senate Enrolled Act ("SEA") 270)¹⁰⁵ revises the method in which a hospital is required to respond to subpoenas or court orders requiring the production of hospital medical records of patients which contain information regarding alcohol and drug abuse treatment, treatment for mental illness, and treatment for communicable diseases including HIV infections and confirmed cases of AIDS.¹⁰⁶ Records containing such information are confidential under the provisions of either federal or state laws.¹⁰⁷

Upon receiving either a subpoena or court order requiring the production of records containing information in one of these three categories, the hospital employee with custody of the original medical records is now required to execute a verified affidavit identifying the record or part of the record that is confidential.¹⁰⁸ The affidavit must also state that the confidential material will only be produced under "federal procedure" in the case of alcohol or drug abuse records or pursuant to a court order after *in camera* review in the case of records containing information regarding treatment for mental illness or treatment for communicable disease including HIV infections and confirmed cases of AIDS.¹⁰⁹

Under prior law, a verified affidavit was used only when the hospital did not have all or part of a particular medical record requested.¹¹⁰ Preparation of the required affidavit did not indicate the existence of confidential information as to alcohol/drug abuse, mental illness, or communicable diseases. On the other hand, hospitals were without any guidance as to the proper method of response to a subpoena or court order requiring the production of a record in its possession which contained confidential information regarding these highly sensitive areas.

SEA 270 attempts to provide a vehicle for hospitals to respond to such requests for production in a manner that does not require the preparation of motions to quash or other documents that normally require the assistance of counsel. Although the statute is well-intentioned, at

105. 1989 Ind. Acts 2004 (codified at IND. CODE ANN. § 34-3-15.5 (West Supp. 1989)).

106. IND. CODE ANN. § 34-3-15.5-6(f) (West Supp. 1989) (alcohol and drug abuse treatment); *id.* § 34-3-15.5-6(g) (treatment of mental illness); *id.* § 34-3-15.5-6(h) (treatment of communicable disease, HIV infection, and confirmed cases of AIDS).

107. See 42 U.S.C. § 290dd-3 (Supp. V 1988) (alcohol treatment); *id.* § 290ee-3 (drug abuse treatment); *id.* § 16-14-1.6-8(b); *id.* § 16-14-1.6-8(f) (treatment for mental illness or developmental disabilities); *id.* § 16-1-9.5-7 (treatment for communicable disease, HIV infection, or a confirmed case of AIDS).

108. IND. CODE ANN. § 34-3-15.5-6(a) (West Supp. 1989).

109. *Id.* § 34-3-15.5-6(f)-(h).

110. IND. CODE § 34-3-15.5-6(e) (1988).

least in the area of records containing information regarding federally funded treatment for alcohol or drug abuse, hospitals responding to subpoenas or court orders by submitting the affidavit required by the statute may unwittingly violate federal regulations.

The confidentiality provisions of title 42 of the United States Code, sections 290dd-3 (alcohol abuse treatment) and 290ee-3 (drug abuse treatment), are implemented by part 2 of title 42 of the Code of Federal Regulations which imposes penalties upon individuals or entities that disclose confidential information regarding alcohol or drug abuse treatment in a manner that fails to comply with the regulations.¹¹¹ Any hospital which provides substance abuse diagnostic, treatment, or referral services and which also receives federal assistance funds, including Medicare or other financial assistance, even though those funds are not used to pay for the diagnosis, treatment or referral of substance abuse patients, is subject to the restrictions on disclosure of information regarding treatment for substance abuse.¹¹²

Under the federal regulations, a response by a facility to a subpoena or court order which implies that the patient has been treated for substance abuse is an impermissible disclosure.¹¹³ Disclosure of "any information which would identify a patient as an alcohol or drug abuser" is prohibited.¹¹⁴ Covered information includes "any record of a diagnosis identifying a patient as an alcohol or drug abuser which is prepared in connection with [or for the purpose of] the treatment or referral for treatment of alcohol or drug abuse" even if the information is never utilized in treatment or referral.¹¹⁵

Disclosure of information is permitted only with specific written consent¹¹⁶ of the patient or pursuant to a court order which has been issued after a proceeding in which the court has found that sufficient cause exists to require production of the records such as to either protect third parties against an existing threat to life or serious bodily harm or to prosecute someone charged with an "extremely serious crime" such as homicide, rape, kidnapping, armed robbery, assault with a deadly

111. Any person who violates any provision of 42 C.F.R. Part 2 or the enabling statutes "shall be fined not more than \$500 in the case of a first offense, and not more than \$5,000 in the case of each subsequent offense." 42 C.F.R. § 2.4 (1988).

112. *Id.* § 2.12. Any entity that holds itself out as providing substance abuse services which also receives federal assistance in any form is also covered.

113. *Id.* § 2.12(e).

114. *Id.* § 2.12(e)(3).

115. *Id.* § 2.12(e)(4).

116. *Id.* § 2.31 (form of written consent). Disclosures made pursuant to a proper written consent must be accompanied by a notice prohibiting redisclosure. *Id.* § 2.32 (specific language required for restriction on redisclosure).

weapon, or child abuse and neglect.¹¹⁷ A court may also order disclosure if it finds that the patient has offered testimony or other evidence in a civil or administrative proceeding regarding the contents of the confidential communication.¹¹⁸ It is clear from the limitations on court ordered disclosure set out in the regulations that many confidential communications will remain beyond the reach of a court order. It is also clear that until the required judicial proceedings have been held, no records or patient identifying information can be released.

The regulations specifically address the manner in which a hospital should respond to a request for disclosure that is not permitted by the regulations. The hospital must initially assume that even subpoenas and court orders are requesting disclosure in an impermissible manner since the restrictions on disclosure apply "whether the holder of the information believes that the person seeking the information already has it, has other means of obtaining it, is a law enforcement or other official, has obtained a subpoena, or asserts any other justification for a disclosure or use which is not permitted by these regulations."¹¹⁹ The mere fact that a subpoena has been issued or a court order has been obtained does not assure the hospital that the procedures required by the regulations were complied with in obtaining the subpoena or court order. In fact, the regulations specify that before a proper order can be issued, the keeper of the records must be given an opportunity to appear and respond to an application for the issuance of the order to produce the documents.¹²⁰

Accordingly, the regulations specify that:

Any answer to a request for a disclosure of patient records which is not permissible under these regulations must be made in a way that will not affirmatively reveal that an identified individual has been, or is being diagnosed or treated for alcohol or drug abuse. *An inquiring party* may be given a copy of these regulations and advised that they restrict the disclosure of alcohol or drug abuse patient records, but *may not be told affirmatively that the regulations restrict the disclosure of the records of an identified patient*. The regulations do not restrict a disclosure

117. *Id.* § 2.63. The preamble to the final regulations stated the rationale for this procedure:

Our aim is to strike a balance between absolute confidentiality for "confidential communications" on one side and on the other, to protect against any existing threat to life or serious bodily harm to others and to bring to justice those being investigated or prosecuted for an extremely serious crime who may have inflicted such harm in the past. 52 Fed. Reg. 21,796, 21,802 (June 9, 1987).

118. 42 C.F.R. § 2.63(a)(3) (1988).

119. *Id.* § 2.13(b).

120. *Id.* §§ 2.64(b), 2.65(b).

that an identified individual is not and never has been a patient.¹²¹

The required federal procedure for responses to requests for disclosure of records containing confidential alcohol/drug abuse information prohibits the use of an affidavit such as the one now required under Indiana Code section 34-3-15.5-6(f)(1)(B) because an affidavit citing the federal alcohol/drug information confidentially statutes identifies the individual whose records have been requested as an alcohol/drug abuser. The Indiana statute imposes a duty on a hospital that receives a subpoena duces tecum or court order requiring the production of medical records for a particular individual to first determine whether the records contain information related to substance abuse which is confidential under federal law.¹²² If the hospital determines that confidential information regarding substance abuse is contained in the records, it must submit a verified affidavit "stating that the confidential record or part of the record will only be provided under the federal procedure for production of the record."¹²³

The Indiana statute's requirement that the hospital must reply that production of the record is subject to federal restrictions directly conflicts with the regulatory prohibition against affirmatively stating that federal regulations restrict the disclosure of the records of an identified patient. The very act of complying in the manner specified in the newly amended Indiana statute violates the federal procedures and may subject the hospital and its personnel to penalties.

C. *Solicitation of Out-of-State Residents by Medicaid Providers*

House Enrolled Act 1270 was enacted out of a concern by legislators that Indiana Medicaid providers were actively soliciting out-of-state residents and thereby increasing the Medicaid burden on Indiana taxpayers. Indiana Code section 12-1-7-16.2 was added by the Act which defines "solicitation" as:

[a] direct communication initiated by a provider doing business in Indiana to an individual or a provider in another state with the intent of inducing a nonresident of Indiana to relocate the person's residence to Indiana for the purpose of obtaining medical assistance under Title XIX of the federal Social Security Act (42 U.S.C. 1396 et seq.).¹²⁴

121. *Id.* § 2.13(c)(2) (emphasis added).

122. IND. CODE ANN. § 34-3-15.5-6(f) (West Supp. 1989).

123. *Id.*

124. *Id.* § 12-1-7-16.2(a).

The Act states that: "A provider licensed by the state and doing business in Indiana may not make a solicitation to a person who is eligible for medical assistance under Title XIX of the federal Social Security Act (42 U.S.C. 1396 et seq.)."¹²⁵

A provider may "market" or "advertise" its services to the general public including the fact that it offers special services such as services to ventilator-dependent patients, AIDS patients, Alzheimer's disease patients, and children.¹²⁶ The Act does not, however, specify whether these enumerated permissive acts include marketing or advertising outside the state.

Violations of this particular provision of the Act can result in the denial of payment for *all* services provided during a specified period of time, termination of the provider agreement, or fines of three times the amount of reimbursement received by the provider plus interest.¹²⁷

D. Unauthorized Practice of Medicine

Public Law 237-1989 (Senate Enrolled Act ("SEA") 289)¹²⁸ amends Indiana Code section 25-22.5-1-2, which governs the unauthorized practice of medicine. Subsection (a) of this provision formerly excluded certain persons and entities from the application of the statute.¹²⁹ SEA 289 adds to the list of exclusions several previously omitted entities, including hospitals licensed under Indiana Code sections 16-10-1 and 16-13-2 (psychiatric hospitals). Also excluded under the new Act are organizations such as corporations, facilities, or institutions "licensed or legally authorized by this state to provide health care or professional services" in any of the health professions.¹³⁰

The exclusion extended to these entities is ostensibly limited by new subsection (c) which prevents these entities from exercising control over the medical judgment of individual practitioners:

An employment or other contractual relationship between an entity described in subsection (a)(20) through (a)(21) and a licensed physician does not constitute the unlawful practice of medicine under this article if the entity does not direct or control

125. *Id.* § 12-1-7-16.2(b).

126. *Id.* § 12-1-7-16.2(c).

127. *Id.* § 12-1-7-15.3.

128. 1989 Ind. Acts 1755 (codified at IND. CODE ANN. § 25-22.5-1-2 (West Supp. 1989)).

129. IND. CODE § 25-22.5-1-2(a) (1988), *amended by* IND. CODE ANN. § 25-22.5-1-2 (West Supp. 1989).

130. Pub. L. No. 237-1989, Sec. 1, 1989 Ind. Acts 1755.

independent medical acts, decisions, or judgment of the licensed physician.¹³¹

Even with this apparent restriction against the corporate practice of medicine, if direction or control over a physician's medical judgment is exercised by the entity under the umbrella of a peer review committee such control is expressly excluded from the definition of the unauthorized practice of medicine.

New subsection (d) states that:

This subsection does not apply to a prescription or drug order for a legend drug that is filled or refilled in a pharmacy owned or operated by a hospital licensed under IC 16-10-1. A physician licensed in Indiana who permits or authorizes a person to fill or refill a prescription or drug order for a legend drug except as authorized in IC 16-6-8-3 is subject to disciplinary action under IC 25-1-9. A person who violates this subsection commits the unlawful practice of medicine under this chapter.¹³²

Section 2 of SEA 289 makes the act of misrepresenting oneself as a physician with the intent to defraud a misdemeanor under Indiana Code section 35-43-5-3.

131. IND. CODE ANN. § 25-22.5-1-2(c) (West Supp. 1989).

132. *Id.* § 25-22.5-1-2(d).

Survey of Recent Developments in Medical Malpractice Law

THOMAS R. RUGE*

The Indiana Court of Appeals, the United States Court of Appeals for the Seventh Circuit and the Indiana Legislature addressed several medical malpractice issues during the survey period. The Indiana Court of Appeals found that a medical review panel has jurisdiction to determine whether a health care provider is "qualified" under the Indiana Medical Malpractice Act.¹ It also reaffirmed its strict foundational requirements for expert testimony.² In addition, the court issued an opinion which opens the door for a plaintiff's recovery for a lost chance at survival regardless of whether survival was probable.³ The federal appellate court found that the federal district court lacked jurisdiction in the case of *Jones v. Griffith*,⁴ a case that was discussed in last year's survey article and which touched on many medical malpractice issues. Finally, the Indiana Legislature increased the minimum amount recoverable for injuries under the Indiana Medical Malpractice Act from five hundred thousand dollars (\$500,000.00) to seven hundred fifty thousand dollars (\$750,000.00).⁵

I. STATE COURT DEVELOPMENTS

A. Jurisdiction of Medical Review Panel to Determine Questions of "Qualified Health Care Provider"

Indiana's Medical Malpractice Act⁶ ("Act"), which applies to medical malpractice actions brought in Indiana courts,⁷ requires that an action against a health care provider be presented to a medical review panel

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1. *Guinn v. Light*, 536 N.E.2d 534, 547 (Ind. Ct. App. 1989).

2. See *infra* notes 32-65 and accompanying text.

3. See *infra* notes 66-84 and accompanying text.

4. 870 F.2d 1363, 1369 (7th Cir. 1989), *rev'g* 688 F. Supp. 446 (N.D. Ind. 1988).

5. Limitations on Recovery, Pub. L. No. 189-1989, § 1 (amending IND. CODE § 16-9.5-2-2 (1988)).

6. IND. CODE. §§ 16-9.5-1-1 to -10-3 (1988).

7. IND. CODE. § 16-9.5-9-2 (1988). Federal law now preempts Indiana law concerning the procedural requirement of the medical review panel in "patient dumping" cases, discussed in Grubbs, *Health Law Update*, 23 IND. L. REV. 391 (1990).

before commencing that action in a state court.⁸ The Act applies to health care providers who are "qualified" under the terms of the Act.⁹ Filing the proposed complaint with the Indiana Insurance Commission tolls the statute of limitations, extending the time in which to file a complaint in state court until ninety (90) days after the claimant receives the opinion of the medical review panel.¹⁰

In *Guinn v. Light*,¹¹ the court addressed the issue of the authority of the medical review panel to decide the question of whether a particular health care provider is "qualified," where the authority would affect the tolling of the applicable statute of limitations. In *Guinn*, the plaintiff alleged that the defendants, two dentists, committed malpractice while treating her on August 10, 1982. She filed her proposed complaint, pursuant to the provisions of the Act,¹² on July 16, 1984. On July 19, 1984, she was informed in writing by the commissioner that the proposed defendants were not "qualified" under the Act. Nonetheless, the parties formed a medical review panel, selected a chairman for the panel, and the defendants served interrogatories. Almost nine (9) months later, on April 15, 1985, the chairman of the panel notified the parties that the medical review panel did not have jurisdiction over the action because the defendants were not "qualified" under the Act. The plaintiff filed her complaint in state court forty-four (44) days after the chairman's notice to the parties.

Once the complaint was filed in state court, the defendants moved for summary judgment, claiming that the plaintiff was barred from bringing the action against them because the statute of limitations¹³ had run on August 10, 1984. The trial court agreed with the defendants and granted the summary judgment against the plaintiff. The trial court held that because the defendants were not qualified under the Act, the statute of limitations had expired during the time that the plaintiff's proposed complaint was pending before the medical review panel.

After the plaintiff's motion to correct errors was denied by the trial court, the plaintiff appealed to the Fourth District Court of Appeals.

8. *Id.* § 16-9.5-9-2(a). The statute provides exceptions for cases where the parties enter a written agreement that the claim is not to be presented to a medical review panel, *id.* § 16-9.5-9-2(b); where the patient's pleadings state that the patient seeks damages of fifteen-thousand dollars (\$15,000.00) or less, *id.* § 16-9.5-9-2.1 (1988); or where the medical review panel fails to render an opinion within the time allowed for a panel opinion, *id.* § 16-9.5-9-3.5.

9. *Id.* § 16-9.5-2-1.

10. *Id.* § 16-9.5-9-1(b).

11. 536 N.E.2d 546 (Ind. Ct. App. 1989).

12. IND. CODE §§ 16-9.5-9-1 to -2 (1977).

13. *Id.* § 16-9.5-9-1.

The court reversed the trial court's grant of summary judgment, holding that the plaintiff was not barred by the statute of limitations:¹⁴

Because there is no statutory exception providing for the statute of limitations to begin running again prior to the claimant's receipt of the medical review panel's opinion, the statute is tolled until that event occurs even though the claimant has actual knowledge defendant is not "qualified" under the Act. Thus, Guinn had ninety days after receiving the review panels' opinion to file her complaint in the trial court, and did so. For those reasons, Guinn's complaint was timely-filed in the Madison Superior Court.¹⁵

In denying the dentists' petition for rehearing, the court only discussed the issue of the medical review panel's authority to determine whether the dentists were qualified under the Act. The defendants argued that the panel did not have authority because, by the provisions of the Act: "The panel shall have the *sole* duty to express its expert opinion as to whether or not the evidence supports the conclusion that the defendant or defendants acted or failed to act within the appropriate standard of care as charged in the complaint."¹⁶ The dentists claimed that the statute, as written, prohibited the medical review panel from deciding whether it has jurisdiction of a case under consideration. Therefore, because the defendants were not qualified, the Act did not apply to them and the old statute of limitations¹⁷ would apply to bar the plaintiffs' action.

The court disagreed, holding "[s]tatutes which vest authority to act in administrative agencies necessarily grant authority to the agency to determine whether it has jurisdiction to act in a given situation."¹⁸ The court cited the United States Supreme Court,¹⁹ the Indiana Supreme Court,²⁰ and an annotation²¹ in support of its holding. Further, the court held that the medical review panel must have authority to determine if a health care provider is qualified under the Act. If the health care provider is not qualified, any action by the medical review panel is *ultra*

14. *Guinn v. Light*, 531 N.E.2d 534, 536-38 (Ind. Ct. App. 1988), *reh'g denied*, 536 N.E.2d 546 (1989).

15. *Id.* at 538.

16. *Id.* at 546 (emphasis supplied) (citing IND. CODE § 16-9.5-9-7 (1988)).

17. IND. CODE § 34-4-19-1 (1941).

18. *Guinn*, 536 N.E.2d at 546.

19. *MacAuley v. Waterman S. S. Corp.*, 327 U.S. 540 (1946).

20. *Anderson Lumber & Supply Co. v. Fletcher*, 228 Ind. 383, 390, 89 N.E.2d 449, 452 (1950).

21. 2 AM. JUR. 2D *Administrative Law* § 332 (1962).

vires and void.²² “Thus, the Medical Review Panel here had authority to determine whether Light and Funderburk were ‘qualified’ health care providers as the *sine qua non* of its jurisdiction to proceed further.”²³ Therefore, the court denied the defendants’ petition for rehearing because the medical review panel had the implied authority to determine whether the dentists were qualified under the Act.²⁴

Judge Garrard, in a separate opinion, concurred with the court. He reasoned that the defendants’ claim required too narrow a reading of the provision. First, the defendants’ interpretation of the medical review panel’s authority would create a procedure contrary to the statutory scheme of the Act: it would require claimants to file a proposed complaint with the commissioner *and* file that complaint in state court to avoid the statute of limitations defense in cases where the health care providers are later determined to be not qualified under the Act. Imposing this requirement would be contrary to the Act. As Judge Garrard stated: “[i]t will be the rare occasion indeed where a claimant knows in advance whether or not his health care provider is qualified. . . . The strict application of I.C. 16-9.5-1-5 without regard to the rest of the Act does not appear to further the legislature’s intent in enacting the statute.”²⁵

Second, Judge Garrard wrote “[a] basic rule of statutory construction admonishes us that a statute is to be construed as a whole.”²⁶ The Act requires all actions²⁷ against health care providers to be presented to a medical review panel, regardless of whether the health care provider is “qualified.”²⁸ Because the defendant dentists were within the definition of “health care providers” in the Act, the plaintiff was required to submit the proposed complaint to the commissioner for reference to the medical review panel.²⁹ Also, the Act’s extension of the statute of limitations to include ninety days after the receipt of the medical review panel’s opinion does not limit its application to the statute of limitations of the Act—rather, it “tolls the *applicable* statute of limitations. . . .”³⁰ Therefore, because the dentists were “health care providers” under the Act, the Act would toll the running of any applicable statute of limitations

22. *Guinn*, 536 N.E.2d at 546-47 (citing *Anderson Lumber*, 228 Ind. at 390, 89 N.E.2d at 452).

23. *Id.* at 547.

24. *Id.* at 549.

25. *Id.* at 548 (Garrard, J., concurring).

26. *Id.* (citations omitted).

27. The Act does except some actions from its requirements.

28. *Guinn*, 536 N.E.2d at 548-49 (Garrard, J., concurring) (citing IND. CODE §§ 16-9.5-9-2, -2.1).

29. *Id.* at 549.

30. *Id.* (citing IND. CODE § 16-9.5-9-1) (emphasis added by court).

until ninety days following the receipt of the medical review panel's opinion.

The court's decision in *Guinn* effectively closed a loophole by which qualified health care providers could unfairly assert a presumably superseded statute of limitations defense against unwary claimants who follow the procedural requirements of the Act. The court's decision confirmed a uniform procedure for medical malpractice cases,³¹ eliminating the risks created for claimants who are uncertain whether the health care provider is or is not a "qualified" health care provider under the Act.

B. Procedural Developments Affecting Expert Testimony in Medical Malpractice Cases

During the survey period, the Indiana Court of Appeals decided three medical malpractice appeals concerning expert testimony.

1. *Sufficiency of Expert Testimony to Contradict a Unanimous Medical Review Panel Opinion.*—*Ellis v. Smith*³² was decided on September 26, 1988 and rehearing was denied on November 10, 1988. The court of appeals reversed the trial court's denial of summary judgment for three reasons. First, summary judgment was appropriate where the plaintiffs failed to provide expert opinion contrary to a negative medical review panel decision. Second, an unverified, unpublished deposition was insufficient to satisfy the requirement of the expert opinion. Finally, affidavits filed late which were based on information not within the affiant's personal knowledge were inadmissible and not sufficient to provide expert testimony contrary to the medical review panel's opinion.³³

In *Ellis*, the plaintiff claimed that the doctor negligently failed to inform them of potential risks involved with an elective surgical procedure. Michael Smith sought the procedure to correct equine contractions caused by muscular dystrophy, corrections which would allow him to place his feet flatly on the ground. If successful, the surgery would have enabled Michael to stand for longer periods. The surgery was not successful; instead, Michael could not walk at all after the surgery. The plaintiff claimed that the doctor performed more extensive surgery than had been discussed without informing them of the risks, thereby causing Michael's premature confinement to a wheelchair.

The plaintiff filed a proposed complaint with the Indiana Insurance Commissioner for reference to a medical review panel, pursuant to the

31. Noting the exceptions allowed by the Act and the preemption by the federal "patient-dumping" statute; *see supra* notes 7-8.

32. 528 N.E.2d 826 (Ind. Ct. App. 1988).

33. *Id.* at 826.

requirements of the Act.³⁴ The medical review panel concluded that the doctor's conduct conformed to the applicable standard of care. The plaintiff filed suit after the panel's decision. The defendant moved for summary judgement, utilizing the panel's opinion as expert testimony that the defendant was not negligent.

In opposition to the defendant's motion for summary judgment, the plaintiff offered the defendant-doctor's deposition without an affidavit verifying the contents and without a motion to publish the deposition. The plaintiff also offered affidavits of a Dr. Smith, filed on the day of the third hearing on defendant's second motion for summary judgment.

The court held that defects in the evidence offered by the plaintiff made summary judgment in favor of the defendant appropriate. The plaintiffs' evidence, whether excluded or admitted, failed to provide expert testimony sufficient to provide a genuine issue of material fact with respect to the appropriateness of the doctor's conduct.³⁵ Because the defendant's deposition was both unverified and unpublished, it was inadmissible for summary judgment consideration.³⁶ Further, even if the deposition was admissible for consideration, it did not provide expert testimony contrary to the medical review panel's opinion because it did not include an opinion that there was a causal connection between the purported inadequate disclosure and the resulting damage.³⁷ Without evidence of the causal connection, the plaintiffs' suit was subject to summary judgment.

Dr. Smith's affidavits were also insufficient to provide expert testimony contrary to the medical review panel's opinion that the defendant's conduct met the applicable standard of care. The plaintiffs filed Dr. Smith's affidavits on the same day as the third hearing on the defendant's second motion for summary judgment.³⁸ The court held that the affidavits were untimely, stating: "[I]t is clear that any filing of opposing affidavits must be done prior to the day of hearing."³⁹ The court also held that the trial court committed reversible error by accepting and considering the affidavits.

The court held that, even if timely, Dr. Smith's affidavits were inadmissible. Citing Trial Rule 56(E),⁴⁰ the court held that Dr. Smith's

34. IND. CODE §§ 16-9.5-1-1 to -10-3 (1988).

35. *Ellis*, 528 N.E.2d at 828.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.* (citing *Larr v. Wolf*, 451 N.E.2d 664, 666 (Ind. Ct. App. 1983)).

40. Trial Rule 56(E) of the Indiana Rules of Trial Procedure provides in part, as follows: "Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein."

affidavits failed to show that she was competent to testify as a medical expert. Dr. Smith's affidavits showed that she had studied medicine in Indiana and was aware of the standard of care in the state. They did not show, however, familiarity with the standard of care in the same or similar locality or a uniform, nationwide minimum standard.⁴¹ The affidavits' defects rendered them inadmissible.

2. *Expert Testimony Against One Defendant Not Provided by Other Defendant's Responses to Request for Admission or Interrogatories.*—In *Shoup v. Mladick*,⁴² decided on May 8, 1989, the Court of Appeals, Third District, held that requests for admissions and interrogatories submitted to one co-defendant doctor were not binding on the other co-defendant and were insufficient to provide expert testimony contrary to a unanimous medical review panel opinion.⁴³ Dr. Miller and Dr. Mladick were named as defendants in a medical malpractice suit by the plaintiffs. The plaintiffs alleged that the plaintiff's ankle had been negligently treated by each of the doctors.

The plaintiffs submitted their proposed complaint to a medical review panel in accordance with the Indiana Medical Malpractice Act. The medical review panel unanimously concluded that the evidence did not support a finding of negligence against Dr. Mladick. However, the panel found that Dr. Miller's conduct did not meet the applicable standard of care and "may have" caused plaintiff's resultant damages. After receiving the panel's opinion, plaintiffs filed their complaint. Dr. Mladick moved for summary judgment.

The plaintiffs argued that expert testimony showing Dr. Mladick's negligence was provided in the admission Dr. Miller gave in response to the plaintiffs' request for admission.⁴⁴ Dr. Miller answered a request for admission by "admitting" that Dr. Mladick was negligent, careless and failed to meet the appropriate standard of care in treating and operating on the plaintiff's trimalleolar fracture of the left ankle, and that he, Dr. Miller, was familiar with the appropriate standard of care.⁴⁵ The plaintiffs argued that Dr. Miller's responses showed Dr. Miller's competency to testify as an expert witness and that it was his opinion that Dr. Mladick failed to meet the appropriate standard of care; thus, summary judgment would be inappropriate where expert opinion contrary to the medical review panel's opinion created a genuine issue of material fact.⁴⁶

41. *Ellis*, 528 N.E.2d at 829 (citing *Wilson v. Sligar*, 516 N.E.2d 1099 (Ind. Ct. App. 1987)).

42. 537 N.E.2d 552 (Ind. Ct. App. 1989).

43. *Id.* at 553.

44. *Id.*

45. *Id.*

46. *Id.*

The court held that Dr. Miller's responses to the plaintiffs' requests for admissions were insufficient to provide expert testimony contrary to the unanimous medical review panel's opinion.⁴⁷ The court upheld the summary judgment granted to Dr. Mladick by the trial court because "[r]equests for admissions of facts addressed to one defendant are not binding upon a co-defendant. T. R. 36 admissions apply to and bind the answering party, not a co-defendant."⁴⁸ Requests for admissions do not bind co-defendants because they are designed to define and limit matters in controversy. "Once admitted, the T. R. 36 fact is settled for all purposes of that cause of action. The need to prove such fact at trial is eliminated."⁴⁹ Here, instead of limiting matters, the plaintiffs attempted to create a matter in controversy by use of the admissions. The court held, however, that without other evidence, "[t]he Shoups' failure to provide admissible expert opinion contrary to a unanimous medical review panel finding defeats their medical malpractice claim against Dr. Mladick."⁵⁰

The Shoups also argued that summary judgment was inappropriate while there was pending discovery. The plaintiffs served supplemental interrogatories upon Dr. Miller prior to the summary judgment. The court held that while the general rule is that summary judgment is inappropriate while discovery is pending, an exception is made when the discovery is unlikely to uncover or develop a genuine issue of material fact.⁵¹ In fact, the supplemental interrogatories did not develop a genuine issue of material fact. Thus, even though the supplementary interrogatories were still pending when summary judgment was granted (the answers were still pending when summary judgment was granted), the answers were submitted prior to the trial court's decision on the plaintiffs' motion to correct errors and still no genuine issue of material fact existed.⁵² The trial court properly granted summary judgment because requests for admissions to one party are insufficient to provide expert medical testimony against a co-defendant, and summary judgment is not inappropriate where pending discovery is unlikely to develop a genuine issue of material fact.

47. *Id.*

48. *Id.*

49. *Id.* (citing F. W. Means & Co. v. Carstens, 428 N.E.2d 251, 257 (Ind. Ct. App. 1981)).

50. *Id.* at 553 (citing Ellis v. Smith, 528 N.E.2d 826 (Ind. Ct. App. 1988)); see *supra* notes 32-41 and accompanying text.

51. 537 N.E.2d at 554 (citing Roark v. City of New Albany, 466 N.E.2d 62, 66 (Ind. Ct. App. 1984)).

52. *Id.*

3. *Expert Testimony Excluded at Trial as Trial Rule 37 Sanction.*—In *Brown v. Terre Haute Regional Hospital*,⁵³ the court affirmed the trial court's exclusion of expert witnesses' testimony as a sanction for noncompliance with a discovery order.⁵⁴ The court held that the plaintiff's conduct during the course of discovery justified the sanction, over the plaintiff's objection that the sanction was too harsh under the circumstances.⁵⁵

Brown was injured in a one-car accident. When he was admitted to Terre Haute Regional Hospital, he could not move from the neck down. He was placed in intensive care with the diagnosis of a cervical spine injury. He was placed in cervical traction with fifteen pounds of weight applied. Brown's condition improved and he began to regain feeling in his extremities. As he made progress, the weight applied to the cervical traction was decreased. A factual issue arose at trial whether Brown complained of a change in his condition when the weight applied had been reduced to five pounds. An x-ray taken the day after the

53. 537 N.E.2d 54 (Ind. Ct. App. 1989).

54. Four other errors asserted by the appellant were not reversible error. Brown argued that the hospital violated Brown's motion in limine, which the trial court had granted. The court disagreed, holding that Brown did not make a proper objection at trial and that the trial court had not abused its discretion in admitting the evidence. *Id.* at 59-60.

Brown next argued that the trial court erred in granting the hospital's motion for judgment on the evidence. Again, the court disagreed. Of the four contentions for which Brown alleged error in the court's removing them from the jury, one was waived by failure to make an argument on appeal, two were removed for the reason that no evidence of a connection between the contentions and the injuries was presented. The final contention concerned the permanency of Brown's injuries. Because the jury found against Brown on the issue of liability, any possible error in removing this contention was harmless. *Id.* at 60.

Brown also claimed that the trial court committed reversible error in denying his motion to amend the pleadings to conform to the evidence. The court found no reversible error, Brown did not show that he was prevented from introducing any evidence, he was not denied any instruction with respect to the evidence, and he was not restricted in his final argument. Any error in denying the motion, the court held, was harmless. *Id.*

Finally, Brown asserted that the trial court erred in instructing the jury. Brown's complaint was based on the trial court's giving of three of the hospital's instructions and denying three of Brown's instructions. Brown argued that the hospital's instructions were misleading and contained inadequate explanations. The court held, however, that Brown's objections to the hospital's allegedly misleading instructions were remedied by one of Brown's instructions, which the trial court gave to the jury. In objecting to the hospital's instructions for providing an inadequate explanation, Brown failed to demonstrate how he was harmed. Brown's objection to the hospital's instruction that expert medical testimony must demonstrate that the plaintiff's injuries were caused by the defendant's negligence was not reversible error because, the court held, it was a correct statement of the law. *Id.* at 61.

55. *Id.* at 58.

reduction to five pounds of applied weight showed that Brown's cervical vertebrae were again out of alignment. Five pounds of weight were added to realign the vertebrae. The next day, Brown's doctor determined that Brown's spinal column was unstable and requested a neurosurgeon's evaluation. Subsequently, the neurosurgeon performed fusion surgery to remedy the recurrent subluxation.⁵⁶

After Brown filed suit against the hospital, the hospital served Brown with interrogatories regarding experts retained by the plaintiff. Brown responded that no experts had been retained. From the time of his initial response, the plaintiff never formally supplemented his answers as required by the Trial Rules.⁵⁷ Brown verbally informed the hospital of five experts, one of whom was Dr. Worth. Thirteen (13) days before trial, Brown filed a witness list including an expert not previously identified. The expert was deposed four days prior to trial. Three days prior to trial, Brown identified yet another expert witness.

The hospital moved the trial court to exclude both new experts' testimony because of their late addition, or alternatively, for a continuance. The hospital also asked Brown, pursuant to the trial rules, whether any previously deposed expert had developed new or different opinions of which the hospital had not been informed. The court granted a one week continuance after denying the defendant's motion to exclude the new experts' testimony. During the continuance, the hospital deposed the new experts and redeposited Dr. Worth because Brown informed it that Dr. Worth had new opinions.

Dr. Worth's new opinions concerned residual injuries resulting from care received at the hospital and Brown's reduced chance of recovery. Dr. Worth affirmed twice at the end of his deposition that he had disclosed all of his opinions. He did not voice any opinion about the effect or existence of a delay between the change in Brown's condition and treatment of that change.

At trial, Brown's attorney asked Dr. Worth for "his opinion as to the effect the passage of time would have on a patient's prognosis after he complains about a change in his condition."⁵⁸ The hospital objected and moved to exclude Dr. Worth's testimony. The trial court sustained the motion, excluding Dr. Worth's testimony about the effect of the delay. At the end of trial, the jury rendered a verdict for the hospital.⁵⁹

On appeal, Brown argued that he had not disobeyed the trial court's discovery order; or, if he had, it was a technical violation which did

56. *Id.* at 56.

57. IND. R. Civ. P. 26(E)(1).

58. *Brown*, 537 N.E.2d at 58.

59. *Id.* at 56, 57-58.

not justify the sanction.⁶⁰ The court held that Brown had violated a specific discovery order, for which violation the trial court properly imposed a sanction within its discretionary authority.⁶¹

Brown claimed that discovery had been conducted informally. Though he had not supplemented his answers to interrogatories pursuant to the trial rules, he had verbally informed the hospital about his experts. Further, he informed the hospital about Dr. Worth's new opinions which led to the second deposition of Dr. Worth. Brown argued that his conduct was in compliance with the trial court's discovery order. The court held that Brown had violated the discovery order. During the continuance Brown was specifically ordered to inform the hospital of new expert opinions. "The purpose for the order was clearly to allow the deposing of these witnesses to discover their new opinion testimony. The opinion testimony of an expert is discoverable pursuant to Indiana Rules of Procedure, Trial Rule 26(B)(4)."⁶² The opinion to which Brown wanted Dr. Worth to testify was not an opinion Dr. Worth revealed during his second deposition. The witness affirmed during his deposition that he had no other opinions, and it was a violation of the trial court's discovery order to introduce additional opinion at trial.⁶³

Brown claimed that his violation was technical, if a violation at all. He argued that discovery had been informal, that no bad faith had been shown, that the gravity of the sanction was too harsh under the circumstances, and that principles of equity should apply. The court disagreed. The court held that the trial court "was within its province in determining Brown had abused discovery despite the informality accepted by the parties. The sanction imposed was not too harsh for the circumstances."⁶⁴ Further, the court held that Brown had ample opportunity to inform the hospital of Dr. Worth's expert opinion concerning the effect of delay prior to the time of trial. Thus "the court did not abuse its discretion when it 'drew the line' and refused to allow Dr. Worth to testify to additional undisclosed opinions."⁶⁵

C. "Loss of Chance" Theory of Damages Adopted

The Indiana Court of Appeals, Second District, also decided a case in which the testimony of the plaintiff's experts was insufficient to prevent summary judgment in favor of the defendants. In *Watson v.*

60. *Id.* at 58.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.* at 59.

Medical Emergency Services,⁶⁶ decided January 16, 1989,⁶⁷ the court affirmed summary judgment in favor of the defendants because the testimony of the plaintiff's experts failed to demonstrate that the defendants' negligence proximately caused damage to the plaintiff. However, the court indicated that the plaintiff's cause of action—for "loss of chance" to live—may be an acceptable theory of damages in Indiana.⁶⁸

In *Watson*, the decedent's widow filed a medical malpractice claim against the defendants for a failure to diagnose cancer. Mr. Watson went to the emergency room of Methodist Hospital in August of 1979 and January of 1980, because he was suffering from a cold. X-rays were taken during the January visit. No diagnosis of cancer was made by the emergency room attendant, the supervising doctor, nor by two radiologists. A lung biopsy was performed on Mr. Watson in June, when it was determined that he had terminal cancer. He died in September of 1980.

Mrs. Watson filed her proposed complaint on behalf of the estate of her deceased husband. The medical review panel unanimously decided that the physicians had not breached their duty of care. Mrs. Watson then filed her complaint in Hamilton County Superior Court after the panel proceedings were concluded. After discovery was conducted, the trial court granted summary judgment in favor of the defendants. The Second District Court of Appeals affirmed the trial court's grant of summary judgment because the plaintiff's expert testimony failed to demonstrate that Mr. Watson's damages were proximately caused by any negligence by the physicians.

The expert's depositions, viewed in favor of the plaintiff, showed a breach of duty owed to Mr. Watson. The court found that an affidavit of one of the plaintiff's experts arguably created a genuine issue of fact as to whether the physicians should have taken more tests and sought a more complete history. Though the affidavit was conclusory and vague, and the depositions of other experts testified specifically that more tests and a more complete history were not indicated by the x-rays, the court found that the plaintiff's evidence was sufficient to avoid summary judgment on the issue of breach of duty.⁶⁹

However, the plaintiff's evidence was not sufficient to avoid summary judgment on the issue of proximate cause. The court found that all the expert witnesses were in agreement that cancer was not a probable diagnosis from the x-rays taken in January of 1980. Further, even if

66. 532 N.E.2d 1191 (Ind. Ct. App. 1989).

67. *Reh'g denied*, February 14, 1989.

68. *Watson*, 532 N.E.2d at 1196 n.2.

69. *Id.* at 1193-94.

more complete testing had revealed the presence of cancer, Mrs. Watson did not present evidence that the cancer was treatable. The court found that the experts' opinions on the hypothetical results of various types of treatments were not opinions "to a reasonable degree of medical certainty."⁷⁰ In fact, the opinions expressed only mere possibilities.⁷¹ Mere possibilities are insufficient to establish an issue of fact:⁷² "None of the experts stated that [Mr. Watson's] life could have been saved or even prolonged had he begun receiving treatment in January."⁷³ Without expert testimony demonstrating that the alleged breach of duty proximately caused Mr. Watson's damages, the plaintiff was subject to summary judgment against her.⁷⁴

The court commented on the plaintiff's theory of damages in a footnote.⁷⁵ The doctrine of "loss of chance" has not been specifically adopted by Indiana precedent. However, the court expressed a favorable view of this theory where a plaintiff's evidence demonstrates a "lost of chance" beyond a mere possibility. An expert's testimony that a patient's chances of survival were reduced as a result of a physician's negligent failure to diagnose a disease may present a justiciable issue of fact of proximate cause for compensable damages. The loss of chance doctrine "requires establishment by a plaintiff that if proper treatment had been given, better results would have followed."⁷⁶

Recognizing a compensable loss for a plaintiff whose chances at a better result have been reduced due to another's negligence is a welcome and reasonable development. To require plaintiffs in medical malpractice cases, especially failure to diagnose cancer cases, to show that with proper care a full recovery was probable is simply too harsh a standard. To the claimant and the claimant's family, a reduction in the chance for a full recovery or a shortening of a life expectancy clearly is a substantial loss.

The first indication that the "loss of chance" doctrine would be an acceptable theory of proximate cause in Indiana is found in a criminal case.⁷⁷ Defendants in *Graham v. State* were convicted of manslaughter because they treated the decedent even though neither defendant had a license to practice medicine in Indiana.⁷⁸ Further, the treatment they

70. *Id.* at 1195.

71. *Id.* at 1195-96.

72. *Id.* at 1195.

73. *Id.* at 1196.

74. *Id.*

75. *Id.* at n.2.

76. *Id.*

77. *Graham v. State*, 480 N.E.2d 981 (Ind. Ct. App. 1985).

78. *Id.* at 94. See also *Bermann v. State*, 486 N.E.2d 653 (Ind. Ct. App. 1985).

gave to the patient weakened the decedent to such an extent "that she was physically unable to undergo the chemotherapy *which could have extended her life.*"⁷⁹ The lost chance for proper treatment satisfied the proximate cause requirement linking the defendant's actions to the patient's death.

There is additional support for this theory of damages in Indiana decisions in the area of expert medical testimony. Indiana courts have stated clearly that a properly qualified medical expert may testify regarding "possibilities" and is not restricted only to opinions based on medical certainty.⁸⁰ For example, in *Kaminski v. Cooper*,⁸¹ plaintiff was awarded a substantial sum following trial in an automobile collision case. On appeal, defendant argued that the trial court improperly admitted expert medical testimony concerning possible future medical conditions of the plaintiff. The opinion testimony of plaintiff's expert physician that plaintiff may need a total knee joint replacement in the future (depending on other factors such as arthritis and pain) was admitted.⁸² The court found the doctor's testimony to be admissible even though the doctor did not state that it was "reasonably medically certain" that this care would be needed. Thus, Indiana courts have recognized that an increased chance for future medical treatment is a compensable loss when the possibility of the need for additional treatment was caused by the negligence of another party.⁸³

In a footnote in the *Watson* case, the court takes only a small but logical step forward from this reasoning. If a plaintiff can recover for possible future treatment, then a loss of the opportunity for a better recovery also is a compensable element of damages in a claim against a health care provider who failed to provide the proper care. This view is accepted in many well-reasoned decisions in other jurisdictions as well.⁸⁴

II. 7TH CIRCUIT

The United States Court of Appeals for the Seventh Circuit reversed the decision of the United States District Court for the Northern District

79. *Id.* (emphasis added).

80. See, e.g., Noblesville Casting Div. of TRW, Inc. v. Prince, 438 N.E.2d 722 (Ind. 1982); Yang v. Stafford, 515 N.E.2d 1157 (Ind. Ct. App. 1987); Kaminski v. Cooper, 508 N.E.2d 29 (Ind. Ct. App. 1987).

81. 508 N.E.2d 29.

82. *Id.* at 30.

83. See *supra* notes 75-76 and accompanying text.

84. This view is accepted in many well-reasoned decisions in other jurisdictions as well. See generally Annotation, *Medical Malpractice: "Loss of Chance" Casualty*, 54 A.L.R. 4th 10 (1987); and for a particularly well-reasoned decision in a failure to diagnose cancer case, see *Wheat v. United States*, 630 F. Supp. 699 (W.D. Tex. 1986).

of Indiana, Fort Wayne Division, in *Jones v. Griffith*.⁸⁵ The district court's opinion⁸⁶ was discussed in last year's survey article.⁸⁷ Judge Posner wrote for the court of appeals, holding that the district court was without jurisdiction to hear the case because the issue was not a justiciable "case or controversy."⁸⁸

The district court's opinion was remarkable in several respects. First, the entry included an order from the federal trial court to an Indiana medical review panel to render a specific finding under Indiana Code Section 16-9.5-9-7(c) that the case involved factual issues requiring resolution by a jury.⁸⁹ Second, the district court found that the standard of care for "informed consent" cases was dependent both on expert opinion and on questions of fact requiring lay witness testimony. Third, the district court found the term "factor," as used in Indiana Code Section 16-9.5-9-7(e) to be a less restrictive term than the phrase "substantial factor" as that phrase was used under Indiana law to define the standard for proximate cause in medical malpractice cases.⁹⁰

On appeal, the court did not find any fault with the district court's analysis of the issues presented by the parties. However, the court reversed the district court on grounds not raised by the parties.⁹¹ The court held that the district court's instructions amounted to an advisory opinion, prohibited by the article III of the United States Constitution.⁹² Because the plaintiff filed a "proposed" complaint, pursuant to the Act, no actual case or controversy was presented to the district court.

Mrs. Jones did not ask the federal district court for damages or any other relief against Dr. Griffith, or for that matter against anyone else. She asked the court to give legal instructions to an advisory panel mulling over a dispute that may never be the subject of a lawsuit.⁹³

85. 870 F.2d 1363 (7th Cir. 1989).

86. *Jones v. Griffith*, 688 F. Supp. 446 (N.D. Ind. 1988) (Lee, J.), *rev'd*, 870 F.2d 1363 (7th Cir. 1989).

87. Ruge, *Medical Malpractice*, 22 IND. L. REV. 535, 543-47 (1989).

88. *Jones*, 870 F.2d at 1366.

89. *Jones*, 688 F. Supp. at 462.

90. *Id.* at 460-61.

91. *Jones*, 870 F.2d at 1366.

92. *Id.*

93. *Id.* at 1365-67. The plaintiff based her action on Indiana Code Section 16-9.5-10-1, which provides in pertinent part as follows: "A court having jurisdiction over the subject matter and the parties to a proposed complaint . . . may, upon the filing of a copy of the proposed complaint and a written motion under this chapter, (1) preliminarily determine any affirmative defense or issue of law or fact that may be preliminarily determined under the Indiana Rules of Procedure; or (2) compel discovery in accordance with the Indiana Rules of Procedure; or (3) both."

The court reasoned that the Act requires procedures similar to administrative proceedings, where a party must exhaust all administrative remedies prior to any recourse to federal courts.⁹⁴ Therefore, the district court was without jurisdiction to act where no justiciable case or controversy was before it.

Whether this decision will have any effect on the state courts in Indiana is yet to be seen. The circuit court of appeals overlooked the specific statutory authority in the Medical Malpractice Act giving trial courts jurisdiction over certain disputes which develop during the medical review panel process.⁹⁵ The court made no suggestions for litigants regarding what should be done when guidance from a court is needed in the course of medical review panel proceedings.

III. LEGISLATIVE DEVELOPMENTS

The last session of the Indiana Legislature passed a bill increasing the total amount recoverable for any injury or death under the Indiana Medical Malpractice Act from \$500,000.00 to \$750,000.00.⁹⁶ The increased limit applies to claims based on acts of malpractice on or after January 1, 1990.⁹⁷ The law was not amended with respect to the total amount of liability for the health care provider which is still limited to \$100,000.00. Thus, claims exceeding \$100,000.00 will be paid by the professional liability insurer for the health care provider up to \$100,000.00 and by the Indiana Patient Compensation Fund up to an additional \$650,000.00.

94. *Id.* at 1367.

95. See IND. CODE §§ 16-9.5-10 et seq.

96. Limitations on Recovery, Pub. L. No. 189-1989, § 1 (amending IND. CODE § 16-9.5-2-2).

97. *Id.*

Survey of Recent Developments in Insurance Law

JOHN C. TRIMBLE*

I. INTRODUCTION

The past year was a busy one in the area of insurance law. Over the course of the survey period¹ there were more than twenty-five published opinions rendered by the state appellate courts, the federal district courts, and the Seventh Circuit Court of Appeals. Of the more than twenty-five cases, several contained interesting new law. This Article will focus upon the cases which are most likely to impact upon practitioners who represent insurance companies, insureds, and claimants.²

The Indiana Court of Appeals decided the most noteworthy case to be discussed in this Article, *Demoss Rexall Drugs v. Dobson*,³ just a few days after the survey period ended. *Demoss* does not specifically address insurance law *per se*, but its impact upon insurance practice is so profound that it cannot be omitted from an insurance law article. In *DeMoss*, the Indiana Court of Appeals expanded the opportunity for a plaintiff to discover the statements and other materials developed by an insurance company in the course of a liability investigation into a plaintiff's claim against the company's insured.⁴

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1. Approximately August 1, 1988 to July 1, 1989.

2. As usual, there were a number of interesting cases that discussed or reaffirmed existing insurance law. See *United States Fire Ins. Co. v. Charter Fin. Group*, 851 F.2d 957 (7th Cir. 1988) (discussing whether an excess insurance carrier has a duty to drop down when the underlying policy is inadequate or non-existent); *Ellington v. Metropolitan Life Ins. Co.*, 696 F. Supp. 1237 (S.D. Ind. 1988) (discussing the issue of ERISA preemption of state substantive insurance law); *Town & Country Mut. Ins. Co. v. Sharp*, 538 N.E.2d 6 (Ind. Ct. App. 1989) (describing a "first aid" clause contained in an automobile policy); *Bush v. Washington Natl. Ins. Co.*, 534 N.E.2d 1139 (Ind. Ct. App. 1989) (reaffirming the rule that an insurer may void a policy for the insured's material misrepresentation even though the fact misrepresented did not relate to the event or loss that gave rise to the pending claim); *High v. United Farm Bureau Mut. Ins. Co.*, 533 N.E.2d 1275 (Ind. Ct. App. 1989) (reaffirming the rule that insurance companies may include language in their policies to preclude "stacking" of uninsured motorist coverages); *Hancock v. Kentucky Central Life Ins. Co.*, 527 N.E.2d 720 (Ind. Ct. App. 1988) (reaffirming the rule that a divorce does not automatically remove an ex-spouse as beneficiary on a life insurance policy).

3. 540 N.E.2d 655 (Ind. Ct. App. 1989).

4. *Id.* at 658.

Other cases reported in this Article will deal with: (1) the efforts of automobile accident victims to recover from a tortfeasor's homeowner insurance coverage; (2) the meaning of "intentional" as used in exclusionary clauses of liability insurance policies; and (3) other miscellaneous issues. The Article will also contain a brief review of insurance related legislation enacted by the 1989 Indiana General Assembly.

II. DISCOVERY OF THE INSURANCE CLAIMS FILE

The decision of the Indiana Court of Appeals in *Demoss Rexall Drugs v. Dobson*⁵ has sent shock waves through the insurance litigation system. In *DeMoss*, the court adopted the broad concept that liability insurance claim investigation files are discoverable for the portion of time that the insurer's investigation was being performed in the ordinary course of business rather than in anticipation of litigation.⁶ For reasons that will be discussed below, the precedent established by *DeMoss* will increase the expense of insurance claims handling, will increase the cost of liability litigation, and will involve the trial court in discovery to a greater degree than was originally anticipated by the trial rules.

A brief examination of earlier precedent demonstrates the significant effect of *DeMoss*. Since 1985, the guidelines concerning the discoverability of an insurance claim file had been established by *CIGNA-INA/Aetna v. Hagerman-Shambaugh*.⁷ In *CIGNA*, the insured brought a breach of contract suit against CIGNA-INA/Aetna after CIGNA refused to honor the insured's first party⁸ claim for flood damage of a water pollution control plant the insured was constructing.⁹ During discovery, the insured requested that CIGNA produce its claim file.¹⁰ CIGNA objected to production on the basis that the file was protected by the work product privilege because it was prepared in anticipation of litigation.¹¹ The trial court ordered the file produced.¹²

In upholding the trial court, the Indiana Court of Appeals cited a line of first party cases from other states in which the courts had held that an insurer does not automatically "anticipate litigation" when in-

5. 540 N.E.2d 655 (Ind. Ct. App. 1989).

6. *Id.* at 658-59.

7. 473 N.E.2d 1033 (Ind. Ct. App. 1985).

8. A "first party" case is one in which the insured is suing his own insurer for breach of contract for failing to pay the insured under the terms of the policy.

9. 473 N.E.2d at 1034.

10. *Id.*

11. *Id.*

12. *Id.* at 1035.

vestigating and evaluating a claim made by its own policyholder.¹³ The court held that CIGNA's claim file was discoverable up until the point that litigation between the insurer and insured was imminent.¹⁴

The reasoning of the court in *CIGNA* was sound in the context of a first party lawsuit. Common sense dictates that in the vast majority of cases an insurer does not automatically anticipate litigation with its insured when a first party claim is submitted for evaluation and payment. Further, in *CIGNA* the insurer's file was particularly relevant because the insurer's good faith was an issue in a punitive damage claim filed by the insured.¹⁵ Thus, in a first party case, an insurer should not be allowed to hide its claim file by painting the "anticipation of litigation" protection with a broad stroke.¹⁶

Therefore, in light of the earlier precedent which allowed discovery of the claim file of the insurer only in first party cases the court of appeals made a quantum leap in *DeMoss* by applying the reasoning of *CIGNA* to third party claims.¹⁷ In *DeMoss*, Farm Bureau Insurance Company provided a policy of liability insurance to DeMoss Rexall Drugs. In August of 1987, the plaintiff, Barbara Dobson, had a prescription filled at the pharmacy. After experiencing physical problems, the plaintiff discovered that the pharmacist had given her the wrong medication, and she reported the error to DeMoss. DeMoss in turn reported the claim to Farm Bureau.¹⁸

The Farm Bureau adjuster assigned to investigate the claim recognized immediately that Mrs. Dobson and her husband would be hard to please because the adjuster had an earlier claim with Mrs. Dobson, and he was also aware that Mr. Dobson had a bodily injury claim pending against his employer.¹⁹ Without much delay, the adjuster went out and took recorded statements from four employees of the pharmacy.²⁰ In the subsequent litigation the Dobsons requested the four statements, and the trial court ordered their production.²¹

13. *Id.* (citing State Farm Fire and Cas. Co. v. Perrigan, 102 F.R.D. 235 (D. Va. 1984); Carver v. Allstate Ins. Co., 94 F.R.D. 131 (S.D. Ga. 1982); Fine v. Bellefonte Underwriters Ins. Co., 91 F.R.D. 420 (S.D.N.Y. 1980); APL Corp. v. Aetna Cas. & Sur. Co., 91 F.R.D. 10 (D. Md. 1980)).

14. 473 N.E.2d at 1035.

15. *Id.* at 1036-37.

16. The anticipation of litigation protection is found in IND. R. Tr. P. 26(B)(3).

17. A third party claim is one in which an insurer provides a liability defense to its insured for a claim being presented by a third party, usually an injured plaintiff.

18. *DeMoss Rexell Drugs v. Dobson*, 540 N.E.2d 655, 656 (Ind. Ct. App. 1989).

19. *Id.*

20. *Id.*

21. *Id.*

On appeal DeMoss challenged the production of the statements on the basis that the statements were protected work product prepared in anticipation of litigation under T.R. 26(B)(3).²² DeMoss also argued that the court should treat statements between an insurer and its insured as a privileged communication under T.R. 26(b)(1).²³

The court made short work of the privilege argument. It noted that no such privilege had yet been adopted in Indiana, and that an evidentiary privilege of that nature was the prerogative of the legislature.²⁴

On the issue of whether the file was protected because it was prepared in anticipation of litigation the court sided with the trial court and ordered the statements produced.²⁵ The court adopted the precedent of *CIGNA-INA/Aetna*²⁶ completely, stating:

[T]he work product doctrine demands more than just a recognition that a claim will eventually lead to litigation; it requires evidence supporting the conclusion that the insurer is actively working based upon the premise that the claim will lead to litigation and has obtained the statements at issue in furtherance of that purpose.²⁷

Even though the court acknowledged that insurance claims adjusters sometimes can recognize that a claim is going to lead to a lawsuit merely because of the nature of the claim and the people involved, that was not enough to meet the anticipation of litigation standard.²⁸

A thorough criticism of *DeMoss* could alone be the subject of an article, but this author will not take that opportunity here. However, suffice to say that the *DeMoss* opinion flies in the face of reality and will wreak havoc in tort and insurance litigation. In the long run, no one will benefit from the *DeMoss* decision. A few examples of anticipated problems may be illustrative.

One immediate effect of the case will be the added burden imposed upon trial courts. When the Indiana trial rules were drafted, they were intended to be self-executing with minimal supervision from the trial court.²⁹ In fact, in order to reduce the burden of discovery pleadings

22. *Id.* (citing IND. R. TR. P. 26(b)(3)).

23. 540 N.E.2d at 656-57 (citing IND. R. TR. P. 26(b)(1)).

24. 540 N.E.2d at 657 (citing *Scroggins v. Uniden Corp. of Am.*, 506 N.E.2d 83, 86 (Ind. Ct. App.), *trans. denied* (1987)).

25. 540 N.E.2d at 658.

26. 473 N.E.2d 1033 (Ind. Ct. App. 1985).

27. *DeMoss*, 540 N.E.2d at 659.

28. *Id.* at 658-59.

29. W. HARVEY, 2 IND. R. OF PROC. ANN. 493 (1987) (quoting *Chustak v. Northern Ind. Pub. Serv. Co.*, 259 Ind. 390, 395, 288 N.E.2d 149, 153 (1972); *Front v. Lane*, 443 N.E.2d 95, 98 (Ind. Ct. App. 1982); *Chrysler Corp. v. Reeves*, 404 N.E.2d 1147, 1151 (Ind. Ct. App. 1980)).

on the trial court, the Indiana Supreme Court changed the rules in 1987 so that discovery pleadings are no longer filed with the court unless a dispute arises.³⁰ A review of the cases involving production of insurance files reveals that an *in camera* inspection of the file is always necessary to allow the trial judge to address relevance and to pinpoint the date at which the company began to anticipate litigation.³¹ As recently as 1976, *in camera* inspections were considered rare.³² Now such inspections will occur in every lawsuit in which an insurer defends someone. Who will bear the attendant costs, as well as the additional delay in litigation?

Aside from the additional burden that *DeMoss* will impose upon insurance-related litigation, the most alarming result is that the relationship between insurers and insureds is sure to be undermined. Under the standard liability insurance policy, insureds have an obligation to cooperate with the insurer in defending claims.³³ Once insureds and their personal attorneys learn that statements taken prior to litigation may be discoverable, the willingness of an insured and his employees or families to give statements may diminish. In fact, in instances in which the insured is facing a punitive damage claim or a similar uninsured exposure, the insured's counsel may be obligated to advise a client not to cooperate. Although insurance claims representatives are by and large very professional and well-trained, they may not appreciate the harm that could be caused to an insured if an inartfully taken statement is produced to the opposition.

Another potential detriment of *DeMoss* is that insurers may now be inclined to limit the nature and amount of pre-litigation investigation rather than risk having their mental impressions, reserves, and the fruits of their labor end up in the plaintiff's hands. The only other alternative will be for insurers to spend the money to employ counsel at a much earlier stage so that counsel can direct investigation and make sure that it is well-documented that the investigation is being done in anticipation of litigation. Unfortunately, the earlier intervention of counsel will add expense, and may result in more litigation.

In view of the anticipated problems and detriments created by the *DeMoss* decision, this author encourages the Indiana Supreme Court to overturn the decision through case law or rule-making. Alternatively,

30. See IND. R. TR. P. 5(D)(2).

31. See, e.g., *DeMoss Rexall Drugs v. Dobson*, 540 N.E.2d 655 (Ind. Ct. App. 1989); *CIGNA-INA/Aetna v. Hagerman-Shambaugh*, 473 N.E.2d 1033 (Ind. Ct. App. 1985) and cases cited therein; *Newton v. Yates*, 170 Ind. App. 486, 353 N.E.2d 485 (1976).

32. *Newton v. Yates*, 170 Ind. App. 486, 494, 353 N.E.2d 485, 490 (1976).

33. See, e.g., Annotation, *Liability Insurer's Waiver of Right, or Estoppel, to Set Up Breach of Co-operation Clause*, 30 A.L.R. 4th 620, 625 (1984).

the Indiana General Assembly should address the question of whether to create the insured-insurer communication privilege advanced by the pharmacy in *DeMoss*.³⁴

III. AVAILABILITY OF HOMEOWNER LIABILITY COVERAGE FOR AUTOMOBILE ACCIDENTS

On two occasions during the survey period, auto accident victims tried to reach the tortfeasor's homeowner's liability coverage for additional compensation.³⁵ In each case, the result was the same: no coverage.

In *Standard Mutual Insurance Co. v. Bailey*,³⁶ decided by the Seventh Circuit Court of Appeals, Christopher Cook was struck by a car while riding his bike. Following the accident Christopher and his parents sued Robert Jones, the driver of the car, and Elodie Bailey, the owner of the car. The suit against Bailey was based upon a theory of negligent entrustment.³⁷

At the time of the accident, Bailey was covered by a Standard Mutual homeowner's policy that provided the following personal liability coverage: "If a claim is made or a suit is brought against any insured for damages because of bodily injury or property damage, we will . . . pay up to our limit of liability for the damages for which the insured is legally liable."³⁸ The policy also contained an exclusion which stated that there would be no personal liability coverage for bodily injury "arising out of the ownership, maintenance, use, loading or unloading of: . . . a motor vehicle owned or operated by, or rented or loaned to any insured. . . ."³⁹

Standard Mutual filed a declaratory judgment action against Bailey and the Cooks to determine whether coverage should apply.⁴⁰ The trial court granted summary judgment for Standard Mutual.⁴¹

On appeal the Seventh Circuit Court of Appeals recognized that this was a case of first impression in Indiana. The Cooks argued that the exclusionary language relating to the operation and use of an automobile should not control because Bailey's liability arose solely from her initial

34. *DeMoss*, 540 N.E.2d at 656-57.

35. *Standard Mut. Ins. Co. v. Bailey*, 868 F.2d 893 (7th Cir. 1989); *Sharp v. Indiana Union Mut. Ins. Co.*, 526 N.E.2d 237 (Ind. Ct. App. 1988).

36. 868 F.2d 893 (7th Cir. 1989).

37. *Id.* at 894.

38. *Id.* at 895.

39. *Id.*

40. *Id.*

41. *Id.*

entrustment of the vehicle.⁴² The court disagreed, and held that operation and use of a motor vehicle are "inextricably intertwined" with negligent entrustment.⁴³ Thus, the Cook boy's injury did arise out of the operation and use of a motor vehicle and the exclusion applied. The court noted that its ruling was in accord with twenty-eight of the thirty-two jurisdictions which have considered the issue.⁴⁴

In *Sharp v. Indiana Union Mutual Insurance Co.*,⁴⁵ the Indiana Court of Appeals had the opportunity to address a very similar question. In *Sharp*, the insured, Richard Leinenbach, was covered by a homeowner's policy with personal liability coverage and an automobile exclusion virtually identical to the one in the *Standard Mutual* case.⁴⁶ During a two day period in November of 1984, Leinenbach went on a drinking binge at his home. While in a state of extreme intoxication,⁴⁷ Leinenbach got into his automobile and subsequently had a head-on collision with Mr. Sharp.⁴⁸

In an attempt to invoke coverage, the Sharps argued that Leinenbach's use of the car was only a concurrent cause of Sharp's injuries.⁴⁹ They argued that Leinenbach's act of drinking to excess was a separate and independent act of negligence for which the homeowner coverage should apply.⁵⁰ In support of their position, the Sharps relied upon several out of state cases which stood for the proposition "that where two separate, independent acts of negligence combine to cause injury and one of those acts is excluded from coverage under an insurance policy, the policy will still cover the damage incurred if the other act of negligence is not excluded under the policy."⁵¹

The court of appeals made short shrift of the Sharps' argument. The court pointed out that it was not even necessary to decide whether it is negligent for a person to become intoxicated in his own home. Without the element of driving the automobile there would be no injury or accident.⁵² Thus, the auto exclusion controlled.

42. *Id.* at 897.

43. *Id.* at 898.

44. *Id.* (citing *Cooter v. State Farm Fire & Cas. Co.*, 344 So. 2d 496 (Ala. 1977)). The reader may wish to review n.6 on page 898 of the opinion for a complete list of the jurisdictions in accord.

45. 526 N.E.2d 237 (Ind. Ct. App. 1988).

46. *Id.* at 239.

47. Leinenbach's blood alcohol content was 0.301. *Id.* at 238.

48. 526 N.E.2d at 238.

49. *Id.* at 240.

50. *Id.*

51. *Id.* (citing *Waseca Mut. Ins. Co. v. Naska*, 331 N.W.3d 917 (Minn. 1983); *Lauver v. Boling*, 71 Wis. 2d 408, 238 N.W.2d 514 (1976); *Mutual Auto Ins. Co. v. Partridge*, 10 Cal. 3d 94, 514 P.2d 123 (1973)).

52. 526 N.E.2d at 240.

The rulings in *Standard Mutual* and *Sharp* are both sound and supportable. In the factual context of these cases, the automobile exclusion in each of the policies was clear and unambiguous. Furthermore, the use of the automobile in causing the injury could not reasonably be separated from the negligence. Now that Indiana has precedent in this area, it should reduce, if not end, further litigation on the subject.

IV. EXCLUSIONS FOR INTENTIONAL ACTS

For years liability insurance policies have contained provisions that have excluded an insured from liability coverage if the injury-producing acts of the insured were intentional.⁵³ During the survey period, the Indiana Court of Appeals handed down two fascinating cases on the subject of intentional acts.⁵⁴ In each instance, the court made new law in Indiana.

A. "Expected" Defined

In *Indiana Farmers Mutual Insurance Co. v. Graham*,⁵⁵ the court of appeals was called upon to interpret the meaning of the word "expected" as used in a standard liability exclusion. Although the word "intended" had been defined before,⁵⁶ the word "expected" had never been defined in this state.⁵⁷

In 1984, Jeffrey and Jean Graham learned that their herd of hogs had contracted an infectious disease that had particular impact upon breeding herds. After the disease was discovered the herd was quarantined. Thereafter, under State Board of Health regulations, the herd could not be sold unless the hogs were vaccinated and tagged, and certain forms filed with the State.⁵⁸

So that the premises could be disinfected, the Grahams arranged to sell the hogs through a broker. The Grahams informed the broker of the disease and the quarantine, but at the broker's request, they did not tag the hogs. Furthermore, the Grahams did not follow the other regulations.⁵⁹ The broker in turn sold the hogs to Mark and Debra

53. See, e.g., Home Ins. Co. v. Neilsen, 165 Ind. App. 455, 332 N.E.2d 240 (1975).

54. *Indiana Farmers Mut. Ins. Co. v. Graham*, 537 N.E.2d 510 (Ind. Ct. App. 1989) and *West Am. Ins. Co. v. McGhee*, 530 N.E.2d 110 (Ind. Ct. App. 1988), *trans. denied* (1989).

55. 537 N.E.2d 510 (Ind. Ct. App. 1989).

56. See *Home Ins. Co. v. Neilsen*, 165 Ind. App. 445, 332 N.E.2d 240 (1975).

57. *Indiana Farmers*, 537 N.E.2d at 512.

58. *Id.* at 510.

59. *Id.*

Good. In doing so, he failed to advise them of the disease. Not surprisingly, the Goods mixed the hogs with their own herd, and ultimately lost their existing herd to the disease.⁶⁰

The Goods filed suit against the Grahams, and the Grahams turned to Indiana Farmers for coverage under a comprehensive farm liability policy. Indiana Farmers responded to the claim by filing a declaratory judgment action against the Grahams. Indiana Farmers contended that it did not have to defend the Grahams for "property damage which is either expected or intended from the standpoint of the Insured."⁶¹ Each party moved for summary judgment. The trial court granted the Grahams' motion and denied Indiana Farmers' motion.⁶²

On appeal, the Indiana Court of Appeals stated at the outset that the policy language "expected or intended" was ambiguous.⁶³ On this point, the court noted that in the 1975 case of *Home Insurance Co. v. Neilsen*,⁶⁴ the parties argued no fewer than three possible definitions of "caused intentionally" before the court finally defined it as "an intentional act of the insured which was intended to cause injury."⁶⁵ The *Neilsen* court held that the type of intent could be proven "either by showing an actual intent to injure or by showing the nature and character of the act to be such that intent to cause harm to the other party must be inferred as a matter of law."⁶⁶

The court opined that the insurance industry must have wanted the terms "expected" and "intended" to have separate meanings, and the term "intended" would simply require a greater degree of proof and a higher degree of probability than the term "expected."⁶⁷ Because no other Indiana court had ever been called upon to define "expected" as used in the exclusion, the court drew on other jurisdictions and defined "expected" as follows: "Expected injury or damage means that the insured acted although he was consciously aware that the harm caused by his actions was practically certain to occur."⁶⁸

Using the definitions of "intended" and "expected" the court found that the Grahams did neither; they were simply negligent.⁶⁹ The trial court ruling in favor of the Grahams was affirmed.⁷⁰

60. *Id.* at 510-11.

61. *Id.* (quoting policy language from the Farmer's policy exclusion).

62. 537 N.E.2d at 510-11.

63. *Id.*

64. 165 Ind. App. 445, 332 N.E.2d 240 (1975).

65. *Indiana Farmers*, 537 N.E.2d at 511 (citing *Home Ins. Co. v. Neilsen*, 165 Ind. App. 445, 451, 332 N.E.2d 240, 244 (1975)).

66. 537 N.E.2d at 511.

67. *Id.*

68. *Id.* (citing *Bay State Ins. Co. v. Wilson*, 96 Ill. 2d 487, 494, 451 N.E.2d 880, 882 (1983)).

69. 537 N.E.2d at 512.

70. *Id.*

A ruling of this nature is helpful and appreciated by practitioners. Although the definition of "expected" adopted by the court is broad enough that every case will be fact-sensitive, the court nevertheless has given a guideline to follow. These cases are usually fact-sensitive anyway, so it is preferable to have a definition even if the definition requires a factual interpretation in each case.

B. *Insanity Defense to the Intentional Act Exclusion*

The case of *West American Insurance Co. v. McGhee*,⁷¹ is one that is sure to increase the intensity of litigation in cases involving the intentional acts exclusion. Even so, it is a well-reasoned and necessary new wrinkle in the body of Indiana law with respect to the intentional act exclusion.

The case arises from a sad and brutal incident in which Mr. Philmore Hankerson bludgeoned to death a woman who lived in his home, and also shot and killed her teenage daughter with a point-blank shotgun blast. A short time later he committed suicide.⁷² Following this incident the deceased woman's estate brought a wrongful death lawsuit against Hankerson's estate.⁷³

Hankerson's estate sought a liability defense from West American under a homeowner's policy that was in force at the time of the incident. West American then filed a declaratory judgment action in which it contended that it owed no defense to Hankerson's estate because Hankerson had violated the policy provision which excluded coverage for "bodily injury . . . which is expected or intended by the insured. . . ."⁷⁴ The trial court, without stating its rationale, held that the estate was entitled to a defense.⁷⁵

On appeal, the court of appeals applied the intent standard⁷⁶ of *Home Insurance Co. v. Neilsen*⁷⁷ and recognized immediately that the nature and character of Mr. Hankerson's conduct was such that his intent to cause harm could be inferred as a matter of law.⁷⁸ However, the court also acknowledged the appellees' argument that Indiana should

70. *Id.*

71. 530 N.E.2d 110 (Ind. Ct. App. 1988), *trans. denied* (1989).

72. *Id.* at 111.

73. *Id.*

74. *Id.* (quoting policy language).

75. 530 N.E.2d at 111.

76. See *supra* notes 83-84 and accompanying text.

77. 165 Ind. App. 445, 332 N.E.2d 240 (1975).

78. *West American*, 530 N.E.2d at 111-12 (citing *Home Ins. Co. v. Neilsen*, 165 Ind. App. 445, 332 N.E.2d 240 (1975)).

adopt an insanity defense to the intentional act exclusion.⁷⁹ After noting that a majority of other jurisdictions had adopted the insanity defense, the court also adopted it.⁸⁰ The court indicated that the purpose of the intentional act exclusion was to prevent persons from benefiting from acts intentionally caused and to deter intentional misbehavior.⁸¹ With such a purpose in mind, the court reasoned that it did not make sense to apply the intentional acts exclusion to persons who lacked the mental capacity to be concerned about the existence of insurance.⁸²

In spite of the court's favorable ruling on the insanity defense, the estate did not prevail on the issue of coverage. The court found there was a presumption that a person is sane until proven otherwise.⁸³ Hankerson's estate bore the burden of proving by a preponderance of the evidence that Hankerson was insane.⁸⁴ Further, the court stated that "[p]roof of legal insanity, in this context, requires some evidence tending to prove that the actor was unable to conform his behavior to societal norms."⁸⁵ In this instance, the only evidence of insanity was the heinous nature of the acts. That was not enough to satisfy the court that Hankerson was insane.⁸⁶

It is hard to quarrel with the reasoning of the court in *West American*. It will be interesting as time passes to see how the defense will develop in Indiana. Although it is a defense that is seldom successful in the criminal setting because it means that a bad actor may be set free, no one knows what factfinders will do with it in the civil context where a successful defense means a victim may receive compensation.

V. MISCELLANEOUS CASES

A. Right to Demand Appraisal

A common provision in physical damage insurance policies is what is known as the appraisal clause. When invoked, an appraisal clause is a speedy means of alternative dispute resolution that enables parties to each select a disinterested appraiser. The two appraisers then select a

79. 530 N.E.2d at 112.

80. *Id.* (citing Annotation, *Liability Insurance: Intoxication or Other Mental Incapacity Avoiding Application of Clause in Liability Policy Specifically Exempting Coverage of Injury or Damage Caused Intentionally by or At Direction of Insured*, 33 A.L.R. 4th 983 (1984)).

81. 530 N.E.2d at 112.

82. *Id.*

83. *Id.* (citing *Rush v. Mcgee*, 36 Ind. 69 (1871)).

84. 530 N.E.2d at 112.

85. *Id.* (citing *Globe Am. Cas. Co. v. Lyons*, 131 Ariz. 337, 641 P.2d 251 (1981)).

86. 530 N.E.2d at 112.

third person known as an umpire. Once the panel is selected the appraisers try to resolve the dispute, and if they are unsuccessful, the umpire will then render the deciding vote.

In *Monroe Guaranty Insurance Co. v. Backstage, Inc.*,⁸⁷ the Indiana Court of Appeals decided for the first time in Indiana the question of when a person may demand an appraisal if the policy is silent on the amount of time allowed.⁸⁸ The answer was short and sweet. The right to demand appraisal may be waived unless it is made "within a reasonable time under the circumstances of the case. . . ."⁸⁹ Waiver occurs when good faith negotiations have ended *and* prejudice has occurred because of the parties' delay in demanding the appraisal.⁹⁰

In this particular case, the court of appeals permitted Monroe Guaranty to demand appraisal even though the insured had already filed suit.⁹¹ In doing so, the court noted that good faith negotiations had ended more than seven months before appraisal had been demanded.⁹² Nevertheless, the court found that no evidence of prejudice to the insured had been presented, and Monroe Guaranty had made a substantial advance payment.⁹³ Furthermore, the court noted that appraisal was an appropriate method for resolving the parties' differences in this case.⁹⁴

The rule enunciated by the court will be helpful to practitioners. However, attorneys should probably be a little more diligent in demanding appraisal than Monroe Guaranty was in this case. It is difficult to imagine that courts are going to be very tolerant of appraisal demands being routinely made after suit has been filed. Attorneys would be well-advised to demand appraisal (if they choose to do so) just as soon as they sense any breakdown in negotiations. Particularly from the vantage point of the insurer, experience has shown that delay in acting upon policy rights rarely works to the insurer's benefit.

B. Statute of Limitations for Insurance Agent's Failure to Procure Coverage

Under Indiana law an insurance agent may be liable to his insurance customer if he fails to procure coverage, fails to procure coverage in

87. 537 N.E.2d 528 (Ind. Ct. App. 1989).

88. *Id.* at 529.

89. *Id.* (citing *Hanby v. Maryland Cas. Co.*, 265 A.2d 28, 30 (Del. Super. Ct. 1970)).

90. 537 N.E.2d at 529 (citing *School Dist. No. 1 v. Globe & Republic Ins. Co.*, 146 Mont. 208, 404 P.2d 889; Annotation, *Time Within Which Demand for Appraisal of Property Loss Must Be Made, Under Insurance Policy Providing for Such Appraisal*, 14 A.L.R. 3d 674 (1967)).

91. 537 N.E.2d at 529.

92. *Id.*

93. *Id.*

94. *Id.*

the right amount, or procures coverage that is inappropriate for the needs of the customer.⁹⁵ The cause of action by the customer may be brought on a theory of negligence or on a theory of breach of an implied contractual duty to use reasonable care in procuring coverage.⁹⁶ Until recently, the question of whether a tort or contract statute of limitations applied to such an action was left open to dispute.

In *Butler v. Williams*,⁹⁷ the Indiana Court of Appeals answered two questions: (1) which statute of limitations applied, and (2) when does the statute begin to run.⁹⁸ On the first question the court imposed the two-year statute of limitations, reasoning that Indiana has adhered to the rule "that the nature or substance of the cause of action determines the applicability of the statute of limitations."⁹⁹ With respect to the errors or omissions of insurance agents the court felt that the nature or substance of the claim is for negligent failure to procure the correct insurance. Thus, the two-year statute was appropriate.¹⁰⁰

On the second question of when the statute begins to run, the court held that it begins to run when the damage occurs.¹⁰¹ The court specifically rejected the idea that the cause of action would accrue when the extent of the damage was ascertainable.¹⁰² Further, the court implied that it would also look to evidence of when the insured knew or should have known the damage had occurred for purposes of deciding the issue of when the statute commences running.¹⁰³

The determination of the court that a two year statute of limitations should apply appears to be sound. However, the holding of the court as to when the statute begins to run will cause problems. Under current liberal notice pleading and relation back rules, it is not always easy for an insured to determine every basis for a suit against him. Furthermore, the absence or inadequacy of coverage is not always known until litigation is old and developed because insurance companies are increasingly providing defenses under a reservation of rights. If the courts apply a "knew

95. See, e.g., *Stockberger v. Meridian Mut. Ins. Co.*, 182 Ind. App. 556, 395 N.E.2d 1272 (1979); *Automobile Underwriters v. Hitch*, 169 Ind. App. 453, 349 N.E.2d 271 (1976).

96. *Carrier Agency v. Top Quality Bldg. Products, Inc.*, 519 N.E.2d 739 (Ind. Ct. App.), *trans. denied* (1988).

97. 527 N.E.2d 231 (Ind. Ct. App. 1988).

98. *Id.* at 233-34.

99. *Id.* at 233 (citing *Whitehouse v. Quinn*, 477 N.E.2d 270, 273 (Ind. 1985); *Shideler v. Dwyer*, 275 Ind. 270, 276, 417 N.E.2d 281, 285 (1981)).

100. 527 N.E.2d at 233-34.

101. *Id.* at 234 (citing *Shideler v. Dwyer*, 275 Ind. 270, 282, 417 N.E.2d 281, 289 (1981); *Monsanto Co. v. Miller*, 455 N.E.2d 392, 394 (Ind. Ct. App. 1983)).

102. 527 N.E.2d at 234.

103. *Id.*

or should have known" standard with respect to the insured's knowledge of damage, then insureds will be fine. If not, insureds and their attorneys will have to be prepared to file suit against their agent the moment it appears that coverage trouble is arising.

VI. STATUTORY AMENDMENTS

The statutory amendments or additions made in the past year are noteworthy only because they display evidence of growing concern for consumers in the Indiana General Assembly. Many of the changes appeared to be in direct response to news stories of the last year.

As an example, in Indiana Code section 27-1-20-21 the legislature expanded the types and amounts of underwriting information that must be reported each year by insurers who provide coverage in such areas as dram shop liability, recreational facility liability, lawyers professional liability, product liability, premises liability, and day care center liability.¹⁰⁴ Without question these reporting requirements were the result of the so-called "liability crisis" wherein insurers were refusing to write coverage in these high risk areas because of allegedly poor underwriting loss ratios.

As additional evidence of growing consumerism, the legislature also passed more rigorous financial reporting procedures for domestic insurance companies;¹⁰⁵ rigorous standards for the marketing and sale of medicare supplement insurance;¹⁰⁶ a definition of and cancellation requirements for farmers' drought insurance;¹⁰⁷ and more stringent guidelines for the marketing, pricing, and underwriting of worker's compensation insurance.¹⁰⁸

One other interesting statutory change occurred in the area of arson prevention.¹⁰⁹ The statute allows certain civil authorities to order an insurer to withhold payment of insurance proceeds for limited periods of time while investigations are pending. It will be curious to see what problems will be caused by such a statute.

104. IND. CODE ANN. § 27-1-20-21 (West Supp. 1989).

105. *Id.* § 27-1-3-9 (1989).

106. *Id.* §§ 27-8-13-1 to -19 (1989).

107. *Id.* §§ 27-7-11-1 to -2 (1989).

108. *Id.* §§ 27-7-2-1.1 to -1.2 (1989).

109. *Id.* § 27-2-13-5 (1989).

Survey of Recent Developments in Indiana Labor Law

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I. INTRODUCTION

During the survey period, several significant employment law issues were decided by the federal and state courts in Indiana. This Article will focus only on those court decisions dealing with "just cause" discharge, unemployment compensation and workplace discrimination under Indiana law.

II. JUST CAUSE DISCHARGE

A. The Collateral Estoppel Effect of Administrative Decisions

On June 19, 1989, the United States District Court for the Southern District of Indiana issued its decision in *Spearman v. Delco Remy Division of General Motors*.¹ In *Spearman*, Indiana law was interpreted, for the first time, as authorizing the application of the doctrine of collateral estoppel based upon an administrative decision issued by the Indiana Employment Security Division.² This case involved Edgar Spearman, an employee working under a month-to-month employment contract who was discharged after having allegedly used his position of trust and confidence to induce his employer, Delco Remy, to purchase packaging crates from a company with which his stepson was affiliated.

Upon discharge, Spearman applied for and was initially awarded unemployment benefits by the Indiana Employment Security Division. Delco Remy appealed this eligibility determination. At hearing before an appeals referee, both Spearman and Delco Remy were represented by counsel and called witnesses on their behalf. Based on the evidence presented at this hearing, the appeals referee, by written decision, reversed Spearman's initial award of benefits. In denying Spearman's claim, the referee determined that Spearman had been discharged for violating a

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1. 717 F. Supp. 1351 (S.D. Ind. 1989).
2. *Id.*

duty of loyalty owed his employer,³ a “just cause” reason for discharge under Indiana Code section 22-4-15-1(d)(8)⁴ that disqualified Spearman from receiving unemployment benefits. Spearman appealed this decision to the Review Board of the Indiana Employment Security Division. At a hearing held before a three-member panel of the Review Board, both Spearman and Delco Remy were again represented by counsel. After this hearing, the Review Board, by written decision, reversed the appeals referee’s decision and found that Spearman had not been discharged for statutory “just cause.”⁵ Delco Remy appealed this decision to the Indiana Court of Appeals, which affirmed the Review Board’s decision. Delco Remy’s petition for transfer to the Indiana Supreme Court was also denied.

After Delco Remy exhausted its appeal rights on this administrative decision of “no just cause,” Spearman filed a diversity action in federal court, alleging that he had been wrongfully discharged by Delco Remy. Spearman then filed a motion for summary judgment, claiming that the Indiana Employment Security Division’s determination that he had not been discharged for statutory “just cause” estopped Delco Remy from relitigating that issue in his wrongful discharge claim.

In responding to Spearman’s motion, the federal district court admitted that “the boundaries of applying administrative decisions to court litigation are not well defined in Indiana.”⁶ However, the court went on to note that the Indiana Supreme Court, in *McClanahan v. Remington Freight Lines*,⁷ had recently recognized, in *dicta*, that “some administrative proceedings may estop relitigation in subsequent civil proceedings.”⁸ The court then quoted, with approval, the four “basic standards”⁹ for administrative collateral estoppel set forth in *McClanahan*:

1. whether the issues sought to be estopped were within the statutory jurisdiction of the agency;
2. whether the agency was acting in a judicial capacity;
3. whether both parties had a fair opportunity to litigate the issues; [and]
4. whether the decision of the administrative tribunal could be appealed to a judicial tribunal.¹⁰

3. *Id.* at 1354.

4. IND. CODE § 22-4-15-1(d)(8) (1982).

5. *Spearman*, 717 F. Supp. at 1355.

6. *Id.* at 1357.

7. 517 N.E.2d 390 (Ind. 1988).

8. *Spearman*, 717 F. Supp. at 1357 (quoting *McClanahan*, 517 N.E.2d at 394).

9. *Id.*

10. *Id.* (quoting *McClanahan*, 517 N.E.2d at 394).

To these expressed standards the court added the following additional "implicit requirements":

5. whether the parties are the same; and
6. whether the issues sought to be barred are the same.¹¹

Turning to the facts at issue, the court found all six of these conditions precedent to the application of administrative collateral estoppel to be present in Spearman's case.¹²

The court found, without further discussion or explanation, that the "agency jurisdiction," "appealability of administrative decision" and "identity of parties" standards had been met.¹³ Turning to the "identity of issues" standard, the court concluded that, while the general issue before the Indiana Employment Security Division was whether Spearman was entitled to unemployment benefits, the *key* issue before both the Review Board and the court was whether Spearman was discharged from his employment for just cause.¹⁴ The court rejected Delco Remy's argument that this "just cause" issue decided administratively by the Review Board differed from the "cause" element¹⁵ of Spearman's wrongful discharge claim, finding that the "breach of duty" rationale advanced by Delco Remy as its statutory "just cause" ground for discharge¹⁶ was the "precise element" of cause at issue in Spearman's wrongful discharge claim.¹⁷ The court also found that the "fair opportunity to litigate" standard had been met, noting that both Spearman and Delco Remy had been represented by counsel, had called witnesses, and had vigorously litigated the issue of "just cause" at each administrative level.¹⁸ Finally, the court found that the "judicial capacity" standard had been met by the Indiana Employment Security Division in deciding Spearman's claim.¹⁹ In the court's view, the fact that both Spearman and Delco Remy had been represented by counsel, had called witnesses, had received detailed written decisions at each administrative level, and had had their case heard in Indianapolis by a three-member Review Board panel whose findings of fact were statutorily recognized as final and conclusive,²⁰ sufficiently "formalized" Spearman's case so as to distinguish it from

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.* at 1357-58.

15. See *Peterson v. Culver Educ. Found.*, 402 N.E.2d 448 (Ind. Ct. App. 1980); *Seco Chems., Inc. v. Stewart*, 349 N.E.2d 733 (Ind. Ct. App. 1976).

16. See IND. CODE § 22-4-15-1(d)(8) (1982).

17. *Spearman*, 717 F. Supp. at 1358.

18. *Id.*

19. *Id.*

20. See IND. CODE § 22-4-17-12(a) (1986).

other Indiana cases²¹ in which administrative collateral estoppel was not applied because of the "informal" nature of the administrative procedures involved.²²

Having found that all six of the above conditions were met, the federal district court stated that it was convinced that, under Indiana law, the Indiana Supreme Court "would apply the doctrine of administrative collateral estoppel to the higher-level, more formal administrative decision in this litigation."²³ Finding no reason to relitigate the issue of whether Spearman was discharged for cause, the court granted Spearman's motion for summary judgment.

B. *Judicial Refinement of the Statutory Definition of "Just Cause"*

The survey period saw further judicial refinement of the statutory definition of "just cause" used to determine eligibility for unemployment benefits under the Indiana Employment Security Act.²⁴ In this regard, Indiana Code section 22-4-15-1(d) defines "discharge for just cause" as including, but not limited to:

- (1) separation initiated by an employer for falsification of an employment application to obtain employment through subterfuge;
- (2) knowing violation of a reasonable and uniformly enforced rule of an employer;
- (3) unsatisfactory attendance, if the individual cannot show good cause for absences or tardiness;
- (4) damaging the employer's property through willful negligence;
- (5) refusing to obey instructions;
- (6) reporting to work under the influence of alcohol or drugs, or consuming alcohol or drugs on employer's premises during working hours;
- (7) conduct endangering safety of self or co-workers; or
- (8) incarceration in jail following conviction of a misdemeanor or felony by a court of competent jurisdiction or for any breach of duty in connection with work which is reasonably owed an employer by an employee.²⁵

In *Meulen v. Review Board of Indiana Employment Security Division*,²⁶ the Second District Court of Appeals refused to limit "just cause"

21. See *McClanahan*, 517 N.E.2d 390 (Ind. 1988).

22. *Spearman*, 717 F. Supp. at 1359.

23. *Id.* at 1360.

24. IND. CODE § 22-4-1-1 (1986).

25. *Id.* § 22-4-15-1(d) (1986).

26. 527 N.E.2d 729 (Ind. Ct. App. 1988).

discharges based on the violation of an employer's work rule to instances in which such violations were "deliberate."²⁷

In *Meulen*, claimant Rita Meulen appealed a Review Board decision which denied her claim for unemployment benefits. Meulen filed this claim after she had been discharged for accumulating six disciplinary write-ups for work rule violations and three disciplinary write-ups for excessive absenteeism, all within the same year. On appeal, Meulen argued that her discharge had not been for statutory "just cause" because she had not *deliberately* violated her employer's work rules. The court was unpersuaded by Meulen's argument, finding that, under Indiana law, an act of employee deliberation "is not required to be demonstrated before benefits may be withheld."²⁸ The court likened Meulen's situation to that found in earlier Indiana cases where "recurring" failures to perform job duties were found to be grounds for "just cause" discharge.²⁹ While noting that Meulen's "mere negligence"³⁰ would not have, in and of itself, constituted statutory "just cause," the court held that her repeated errors and excessive absenteeism demonstrated an overall course of conduct sufficient to justify a finding of "just cause" discharge.³¹

In *Voss v. Review Board Department of Employment & Training Services*,³² the Second District Court of Appeals also refused to carve out an exception to the statutory definition of "just cause" in instances where employee conduct that otherwise constituted grounds for "just cause" discharge was, nonetheless, "reasonable" under the circumstances.³³ This case arose when claimant Larry Voss was discharged for violating his employer's work rules by placing approximately 190 unauthorized long distance calls to his wife and to a betting agency on his employer's telephone without reporting and/or paying for the calls. On appeal from an unfavorable Review Board determination, Voss argued that it had not been "unreasonable" for him to have made these telephone calls and, therefore, that his work rule violations did not constitute a "just cause" reason for discharge. The court rejected this argument, finding that the "reasonableness" of Voss' telephone calls was "not relevant" to a finding that his "specifically prohibited and excessive conduct" constituted "just cause" for discharge.³⁴

27. *Id.*

28. *Id.* at 730.

29. See *Hale v. Review Bd. of Ind. Emp. Sec. Div.*, 454 N.E.2d 882 (Ind. Ct. App. 1983); *White v. Review Bd. of Ind. Emp. Sec. Div.*, 280 N.E.2d 64 (Ind. Ct. App. 1972).

30. *Meulen*, 527 N.E.2d at 730.

31. *Id.*

32. 533 N.E.2d 1020 (Ind. Ct. App. 1989).

33. *Id.*

34. *Id.* at 1022.

Finally, in *Beene v. Review Board of Indiana Department of Employment & Training Services*,³⁵ the Second District Court of Appeals refined and re-stated the circumstances under which an employer's "no-fault" attendance policy constitutes a "reasonable" work place rule whose violation can be used as grounds for an employee's "just cause" discharge.³⁶ In this case, claimant Carolyn Beene was discharged after accumulating a dischargeable number of absences under her employer's written "no-fault" attendance policy. Some of these absences, such as those caused by Beene's or her children's illness, were considered "excused absences" by her employer. Nevertheless, the Review Board upheld earlier claims deputy and appeals referee findings that Beene had violated a "reasonable and uniformly enforced" work rule and had thus been discharged for "just cause." On appeal, Beene argued that her employer's "no-fault" attendance policy was not a "reasonable" work rule, because it counted towards termination "excused" absences that were beyond her control. The court rejected this argument, finding, as a matter of law, that the "no-fault" attendance policy at issue was a reasonable and uniformly enforced rule whose violation justified Beene's discharge.³⁷

In so ruling, the court acknowledged that its decision was "somewhat at odds with decisions of other states whose statutes rely on a finding of 'misconduct' or 'willful misconduct' rather than 'just cause' in denying unemployment compensation."³⁸ However, the court stated that, in Indiana, the fact that Beene's absences were caused by occurrences "beyond her control" was "not the litmus test."³⁹ The court noted that, in 1983, it had held that a "no-fault" attendance policy which counted "excused" absences towards discharge was statutorily "unreasonable,"⁴⁰ but that it soon retreated from this earlier *per se* rule and decided to determine the "reasonableness" of "no-fault" attendance policies on a case-by-case basis.⁴¹ In *Beene*, the court concluded that the attendance policy under which Beene had been discharged was a "reasonable" work rule because it "protected the Employer's interest in the efficient running of its business by preventing against the practice of certain employees of

35. 528 N.E.2d 842 (Ind. Ct. App. 1988).

36. The knowing violation of a reasonable and uniformly enforced work rule constitutes "just cause" for discharge. IND. CODE ANN. § 22-4-15-1(d)(2) (Burns Supp. 1989).

37. *Beene*, 528 N.E.2d at 845.

38. *Id.* at 846.

39. *Id.*

40. See *Love v. Heritage House Convalescent Center*, 463 N.E.2d 478 (Ind. Ct. App. 1983).

41. See *Jeffboat, Inc. v. Review Bd. of Ind. Emp. Sec. Div.*, 464 N.E.2d 377 (Ind. Ct. App. 1984).

being frequently 'ill'.⁴² In affirming the decision of the Review Board, the court concluded that the attendance policy at issue sufficiently safeguarded employees by providing "some leeway for cases of long-term illness, "allowing verified instances of "real emergencies" to be considered on their merits, and allowing employees to "move back one step in the discipline progression" if they remained discipline-free for a stated period of time.⁴³

III. UNEMPLOYMENT COMPENSATION

A. Due Process and Equal Protection of Law

During the survey period, Indiana courts continued to review unemployment compensation decisions with an eye toward the overall due process and equal protection rights afforded the parties affected by such decisions. In *Carter v. Review Board of Indiana Department of Employment & Training Services*,⁴⁴ the First District Court of Appeals refused, on due process grounds, to make conclusive the general presumption under Indiana law that notices sent through the mails are received by their respective addressees.⁴⁵ Claimant John Carter had initially been found eligible for unemployment benefits, but his employer appealed this initial determination. Upon appeal, the Indiana Department of Employment and Training Services mailed a hearing notice to Carter. Nevertheless, Carter failed to appear at the appeals referee hearing, and his favorable eligibility determination was reversed. Carter appealed this decision to the Review Board, claiming that he had not received notice of the hearing and had therefore been denied the opportunity to attend it and present evidence in his behalf. The Review Board denied Carter's appeal without addressing this timely notice issue.

On appeal, the First District Court of Appeals reversed, remanding the case to the Review Board for an evidentiary hearing to be held on Carter's claim of inadequate notice.⁴⁶ The court distinguished this case from earlier Indiana cases in which claimants had already presented their evidence to an appeals referee and then appealed the referee's post-hearing decision.⁴⁷ In such cases,⁴⁸ the court agreed that due process of

42. *Beene*, 528 N.E.2d at 846.

43. *Id.*

44. 526 N.E.2d 717 (Ind. Ct. App. 1988).

45. See *Osborne v. Review Bd. of Ind. Emp. Sec. Div.*, 381 N.E.2d 495 (Ind. Ct. App. 1978); see also *Miedreich v. Lauenstein*, 232 U.S. 236 (1914).

46. *Carter*, 526 N.E.2d at 719.

47. *Id.*

48. See *Frederick v. Review Bd. of Ind. Emp. Sec. Div.*, 448 N.E.2d 1230 (Ind. Ct. App. 1983); *Whirlpool Corp. v. Review Bd. of Ind. Emp. Sec. Div.*, 438 N.E.2d 775 (Ind. Ct. App. 1982).

law did not require the Review Board to hold any additional evidentiary hearings.⁴⁹ In Carter's case, however, where he had no opportunity to present *any* evidence on his timely notice claim, the court viewed this total lack of opportunity to be heard on that issue as constituting a "deprivation of due process"⁵⁰ that could only be remedied by the holding of an additional evidentiary hearing.

In *Stanley v. Review Board of Department of Employment & Training Services*,⁵¹ the First District Court of Appeals also reversed a Review Board decision on due process grounds. The Review Board had reversed an appeals referee's findings after conducting only a "paper review" of the case record. Claimant Robert Stanley had been discharged for failing to timely report an absence from work, in violation of a written work rule. Before the appeals referee, Stanley alleged that he had timely notified his employer of his work absence, an assertion denied by the employer's witnesses. The appeals referee resolved this credibility issue in Stanley's favor. The Review Board reversed, however, finding that Stanley had failed to adequately identify the person he claimed to have contacted to report his absence.

On appeal, Stanley argued that the Review Board's reversal of its appeals referee's decision, which was based solely on witness credibility, violated his right to due process of law. The court agreed, creating an exception to the general rule of law on administrative review that was, in the court's own words, at odds with "the weight of state and federal authority."⁵² As noted by the court, administrative agencies under federal law are generally "allowed to make findings on issues of credibility without taking live testimony."⁵³ This rule of law has been followed in Indiana,⁵⁴ at least in cases where witness credibility has not been "the sole determinative factor."⁵⁵ The court also recognized that, even in cases where credibility is the determinative factor, other courts⁵⁶ have not prohibited "paper review" credibility determinations, but only re-

49. *Carter*, 526 N.E.2d at 719.

50. *Id.*

51. 528 N.E.2d 811 (Ind. Ct. App. 1988).

52. *Id.* at 813.

53. *Id.*; see also *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951); *Hameetman v. City of Chicago*, 776 F.2d 636 (7th Cir. 1985).

54. See *Wampler v. Review Bd. of Ind. Emp. Sec. Div.*, 498 N.E.2d 998 (Ind. Ct. App. 1986); *St. Mary's Med. Center v. Review Bd. of Ind.*, 493 N.E.2d 1275 (Ind. Ct. App. 1986); *Public Serv. Co. v. Review Bd. Of Ind. Emp. Sec. Div.*, 451 N.E.2d 371 (Ind. Ct. App. 1983); *Sloan v. Review Bd. of Ind. Emp. Sec. Div.*, 444 N.E.2d 862 (Ind. Ct. App. 1983).

55. *Stanley*, 528 N.E.2d at 814.

56. See *Parker v. Bowen*, 788 F.2d 1512 (11th Cir. 1986); *Pieper Elec. Inc. v. Labor and Indus. Review Comm.*, 346 N.W.2d 464 (Wis. 1984).

quired an administrative review board “to include in the record either its reasons for rejecting the lower tribunal’s credibility determination . . . or some indication that the lower factfinder’s credibility assessment could be gleaned from the record or from personal consultation with that factfinder.”⁵⁷

Nevertheless, while acknowledging the existence of these contrary court decisions, the court chose to prohibit outright the “paper review” reversal of appeals referee decisions where witness credibility is the determinative factor in the case. The court stated that, in cases such as these, where witness credibility is “the sole and determinative factor in reversing a referee’s finding”⁵⁸ and “the testimony of neither party can be discredited by impeachment, nor is there any evidence that the individuals testifying were in any way incapacitated,”⁵⁹ a claimant’s due process rights will be violated unless the Review Board first conducts a second hearing at which it is able to observe for itself the testimony of material witnesses.⁶⁰

Finally, in *Winder v. Review Board of Indiana Employment Security Division*,⁶¹ the Second District Court of Appeals limited, on equal protection grounds, the circumstances under which claimants can be denied unemployment benefits.⁶² *Winder* involved a claimant who had worked for one employer as a full-time caseworker and for another employer as a part-time cashier. Eleven days after the claimant voluntarily quit her part-time position, she was discharged from her full-time job. Under Indiana Code section 22-4-15-1(c)(1), a claimant is disqualified from receiving unemployment benefits if, “having been simultaneously employed by two (2) employers, he leaves one (1) such employer voluntarily without good cause in connection with the work” and does not thereafter remain “in employment with the second employer for at least ten (10) weeks subsequent to leaving the first employer.”⁶³ In reliance on this statutory language, the Review Board disqualified *Winder* from receiving unemployment benefits, as she had not remained with her second employer for at least ten weeks after leaving her first employer.⁶⁴ On appeal, *Winder* argued that this statutory law had been applied so as to deny her equal protection of law, by treating persons “who qualify for benefits after voluntarily quitting one job, and who subsequently lose a second

57. *Stanley*, 528 N.E.2d at 814.

58. *Id.* at 815.

59. *Id.*

60. *Id.*

61. 528 N.E.2d 854 (Ind. Ct. App. 1988).

62. *Id.* at 855.

63. IND. CODE § 22-4-15-1(c)(1) (1982).

64. *Winder*, 528 N.E.2d at 855.

job, differently from those who qualify for benefits after involuntarily losing their only job.”⁶⁵

In analyzing Winder’s case, the court first used a “rational relationship” test⁶⁶ to determine whether the different treatment afforded Winder, in relation to claimants who had held only one job, was related to “legitimate state goals.”⁶⁷ The court noted that two of the expressed statutory purposes for the enactment of the Indiana Employment Security Act were to “provide for payment of benefits to persons unemployed through no fault of their own [and] to encourage stabilization in employment.”⁶⁸ Keeping these “state goals” in mind, the court concluded that Winder had lost her full-time job through “no fault of her own” and had only quit her part-time job with the expectation that she would still be able to maintain “stable employment” by working at her full-time job.⁶⁹ As Winder had never voluntarily become unemployed and would have been entitled to unemployment compensation if she had never held her part-time job, the court reasoned that to deny her unemployment benefits solely because she had held two jobs, instead of one, bore “no rational relationship to the goals of the Indiana Employment Security Act”⁷⁰ and denied Winder equal protection of law.⁷¹ For this reason, the court reversed the Review Board and found Winder eligible for unemployment benefits.⁷²

B. Unemployment Compensation During Periods of Labor Unrest

During the survey period, Indiana courts refused to expand the circumstances under which employees can be found ineligible for unemployment benefits during periods of labor unrest, and limited the circumstances under which picketline misconduct can be used as grounds for “just cause” discharge.

Indiana Code section 22-4-15-3(a) states that:

An individual shall be *ineligible* for waiting period or benefits rights: For any week with respect to which his total or partial or part-total unemployment is due to a *labor dispute* at the factory, establishment or other premises at which he was last employed.⁷³

65. *Id.* at 856.

66. See *Jenkins v. Hayes*, 560 F. Supp. 918 (S.D. Ind. 1983).

67. *Winder*, 528 N.E.2d at 856.

68. *Id.* (quoting IND. CODE § 22-4-1-1 (1986)).

69. *Id.* at 857.

70. *Id.*

71. *Id.*

72. *Id.*

73. IND. CODE § 22-4-15-3(a) (1980) (emphasis added).

In *USS, A Division of USX Corp. v. Review Board of Indiana Employment Security Division*,⁷⁴ the Fourth District Court of Appeals refused to broaden the definition of “labor dispute” used to determine eligibility for unemployment benefits under Indiana law.⁷⁵ In this case, the United Steelworkers of America and USS had been involved in collective bargaining negotiations. After several weeks of hard bargaining failed to produce a new labor contract, and although contract negotiations were still in progress, USS shut down its plant and locked out those employees who tried to report for work. These employees then filed claims for unemployment benefits, which were granted after the Review Board determined that the employees had not become unemployed “due to a labor dispute” under Indiana law.⁷⁶ USS appealed this administrative decision.⁷⁷

On appeal, the court chose to follow the standard first enunciated in *Boitz Manufacturing Co. v. Review Board of Indiana Employment Security Division*⁷⁸ for determining whether claimants were unemployed due to a “labor dispute.”⁷⁹ This standard states that a statutory “labor dispute” does not exist when “bargaining is in a fluid state and no impasse has occurred.”⁸⁰ In using this “Boitz standard,” the court declined USS’s invitation to instead use an “any controversy” standard.⁸¹ In refusing to adopt this proffered standard, the court stated that such a standard “would defeat the act’s declared purpose⁸² when negotiations are still fluid [by] . . . allow[ing] management to immediately ‘lockout’ [sic] employees in an effort to coerce them into settlement.”⁸³ As employees would almost always be ineligible for unemployment compensation during “controversies” such as contract negotiations, the court reasoned that the “any controversy” standard did not square with the act’s declared purpose which requires the encouragement of “good faith collective bargaining in the interest of public policy.”⁸⁴ The court affirmed

74. 527 N.E.2d 731 (Ind. Ct. App. 1988).

75. *Id.*

76. *Id.* at 734.

77. *Id.*

78. 143 Ind. App. 17, 237 N.E.2d 597 (1968).

79. *USS*, 527 N.E.2d at 735.

80. *Boitz*, 143 Ind. App. at 23, 237 N.E.2d at 601.

81. *USS*, 527 N.E.2d at 737.

82. “The primary purpose of the [Employment Security] Act is ‘to provide for the payment of benefits to persons unemployed through no fault of their own,’ and such purpose is ‘essential to the public welfare.’” *Id.* (citing *City Pattern & Foundry Co. v. Review Board*, 147 Ind. App. 636, 640, 263 N.E.2d 218, 222 (1970)).

83. *Id.* at 737-38.

84. *Id.* at 738.

the Review Board's decision to award unemployment benefits to the claimants.⁸⁵

In *Hehr v. Review Board of Indiana Employment Security Division*,⁸⁶ the Second District Court of Appeals limited the circumstances under which picket line misconduct could be used to justify the "just cause" discharge of striking employees. This case arose after four striking employees were discharged for damaging or attempting to damage vehicles crossing their picket line. One of these employees, Wade Hehr, was discharged for striking these vehicles with his hands, while the other employees were discharged for scratching and hitting the vehicles with clubs and other objects. Upon discharge, these employees applied for, and were denied, unemployment benefits.

On appeal, the court acknowledged that employees who damage the property of co-workers located on the employer's premises, or who engage in conduct which constitutes a substantial step towards damaging such property, breach a duty reasonably owed their employer and subject themselves to "just cause" discharge.⁸⁷ However, in applying this general rule to the instant case, the court found it necessary to distinguish between Hehr's actions in hitting vehicles with his hands and the actions of the other claimants in hitting vehicles with other objects. The court found it reasonable to conclude that "the use of an instrument such as a club in intentionally striking a vehicle constitutes a substantial step towards damaging property."⁸⁸ However the court concluded that, absent proof that Hehr's conduct violated a uniformly enforced work rule or resulted in actual property damage, the fact that Hehr intentionally struck vehicles with his hands did not, without evidence of the force he used, lead to a conclusion that his actions "were likely to cause damage."⁸⁹ For this reason, the court awarded Hehr unemployment benefits.⁹⁰

C. Allowable Deductions From Unemployment Benefit Payments

Indiana Code section 22-4-5-1 states, in relevant part, that income deductible from unemployment benefit payments includes:

- (1) renumeration for services from employing units;

85. *Id.*

86. 534 N.E.2d 1122 (Ind. Ct. App. 1989).

87. *Id.* at 1126-27.

88. *Id.* at 1129.

89. *Id.* at 1127.

90. *Id.* at 1129. In dissent, Judge Hoffman found that, because Hehr's actions "had the potential to be dangerous," they satisfied the "likely to cause damage" prerequisite to a finding of "just cause" discharge. *Id.* at 1130 (Hoffman, J., dissenting).

- (2) dismissal pay;
- (3) vacation pay;
- (4) pay for idle time;
- (5) holiday pay;
- (6) sick pay;
- (7) traveling expenses;
- (8) net earnings from self-employment;
- (9) payments in lieu of compensation for services;
- (10) awards by the National Labor Relations Board of additional pay, back pay or for loss of employment; or
- (11) payments made to an individual by an employing unit pursuant to the terms of the Fair Labor Standards Act.⁹¹

Recently in *Green Ridge Mining v. Indiana Unemployment Insurance Board*,⁹² where the scope of this statute was at issue, the First District Court of Appeals refused to consider payments made pursuant to a written settlement agreement, but not designated as "back pay," as income statutorily deductible from a claimant's unemployment benefit payments.

In *Green Ridge*, the employer had discharged claimant Mark Kraus for his alleged bad attitude and inability to get along with others. Upon termination, Kraus filed a claim for unemployment benefits, which was granted. Kraus then filed a complaint against Green Ridge with the Federal Mine, Safety and Health Review Commission, United States Department of Labor ("MSHA"). In this MSHA complaint, Kraus alleged that he had been terminated in retaliation for Green Ridge having received an MSHA citation for failing to report a workplace injury previously suffered by Kraus.

To settle this matter short of litigation, Kraus and Green Ridge entered into an agreement by which Green Ridge would pay Kraus \$15,000 in exchange for the withdrawal of his MSHA complaint. This settlement agreement expressly released Green Ridge "from any and all liability for known claims and demands . . . arising out of or relating to" Kraus' unemployment.⁹³ However, it did *not* specifically designate any portion of this \$15,000 payment as "back pay" for income Kraus lost as a result of his discharge. In the court's view, the failure to designate a portion of this payment as "back pay" distinguished this case from earlier Indiana cases in which monetary awards designated as "back pay" had been considered income statutorily deductible from

91. IND. CODE ANN. § 22-4-5-1 (Burns Supp. 1989).

92. 541 N.E.2d 550 (Ind. Ct. App. 1989).

93. *Id.* at 552.

unemployment benefit payments.⁹⁴ The court concluded that, as Kraus' settlement payment did not fall squarely within a specific category of statutorily deductible income, Green Ridge had the burden of demonstrating that this payment "was intended to replace income lost during any period of unemployment."⁹⁵ As Green Ridge failed to satisfy this burden of proof, the court refused to allow the deduction of this settlement amount from Kraus' unemployment benefit payments.⁹⁶

IV. WORKPLACE DISCRIMINATION

A. Allocation of Burden of Proof in Retaliation Cases

This survey period saw the Indiana Supreme Court clearly state, for the first time, what the proper allocation of proofs is to be in retaliation cases decided under Indiana law. In *Indiana Civil Rights Commission v. Culver*,⁹⁷ Culver Military Academy had hired Martha Bernauer as a reading instructor. As was Culver's practice, Bernauer was required to successfully complete a three-year probationary period before she could become tenured. The year after her hire, Bernauer filed a complaint with the Indiana Civil Rights Commission ("ICRC"), alleging that Culver had discriminated against her on the basis of her sex as a result of its allegedly unequal pay and insurance provisions. In response to this complaint, Culver changed its insurance policy to correct any disparities in insurance coverage that were based on sex. Meanwhile, the ICRC found no probable cause existed on Bernauer's equal pay claim. However, shortly after this matter was settled, Bernauer's position at Culver was eliminated.

In response to her dismissal, Bernauer filed another complaint with the ICRC, this time claiming that she had been terminated in retaliation for having filed a sex discrimination complaint. In response, Culver explained that it had hired new school superintendents in both 1974 and 1975, and that the first of these superintendents had eliminated Culver's reading program—thus necessitating Bernauer's dismissal. However, as Culver's evidence showed, the second of these superintendents reinstated the school's reading program and hired a new reading instructor. Culver argued that it was this unforeseen change in educational emphasis, rather than any retaliatory motive on its part, that led to Bernauer's dismissal. After completing its investigation of this complaint, the ICRC found

94. *Green Ridge Mining*, 541 N.E.2d at 552; see, e.g., *Frost v. Review Bd. of Ind. Emp. Sec. Div.*, 432 N.E.2d 459 (Ind. Ct. App. 1982).

95. *Green Ridge Mining*, 541 N.E.2d at 552.

96. *Id.*

97. 535 N.E.2d 112 (Ind. 1989).

no probable cause existed on Bernauer's retaliatory discharge claim. Bernauer appealed this finding, and a second ICRC investigation led to another "no probable cause" finding. Bernauer then appealed this finding, and was allowed to meet privately with the ICRC Commissioner. As a result of this private meeting, the Commissioner overruled the no probable cause determinations and found probable cause to exist on Bernauer's claim. A subsequent hearing officer's determination held that Culver had retaliated against Bernauer by cancelling its reading program and by not renewing Bernauer's employment at the end of her probationary period.

In so ruling, the ICRC hearing officer based his decision, in part, on an erroneous finding that Culver's reading program had been cancelled and then reinstated by the *same* school administrator. Although the Commission later recognized this factual error, it still accepted its hearing officer's findings and conclusions and ordered Culver to reinstate Bernauer with back pay. One of these conclusions of law accepted by the Commission was the hearing officer's conclusion that, once Bernauer had made a *prima facie* case of retaliation, the burden shifted to Culver "to prove that retaliation played no part in the decision to terminate" her.⁹⁸

On appeal from the Commission's decision, the Marshall Superior Court reversed and remanded, concluding that the ICRC's ultimate finding of discriminatory retaliation had been premised, in part, on its above-mentioned erroneous finding of fact. The Third District Court of Appeals reversed, finding that the trial court had improperly reweighed the evidence and had substituted its own judgment on the facts for that of the Commission in reaching its decision. Culver's petition to transfer finally brought this case before the Indiana Supreme Court.

The Indiana Supreme Court reversed again, and affirmed the trial court's decision and order. In so ruling, the court found that the ICRC had erred in shifting to Culver the burden of proving that retaliation played no part in its decision to terminate Bernauer.⁹⁹ As part of its decision, the court expressly adopted the three-step burden allocation formula used by federal courts to allocate burdens of proof in retaliation cases.¹⁰⁰ Under this formula, as set forth by the United States Supreme Court in *Texas Department of Community Affairs v. Burdine*,¹⁰¹ "the

98. *Id.* at 115.

99. *Id.*

100. *Id.*

101. 450 US 248 (1981). Under this burden allocation formula, the plaintiff has the initial burden of proving, by the preponderance of the evidence, a *prima facie* case of discrimination. The defendant must then articulate a legitimate, nondiscriminatory reason for its actions. The plaintiff then has an opportunity to prove that the reasons offered by the defendant were not its true reasons, but a pretext for discrimination.

ultimate burden of persuasion that the defendant engaged in unlawful discrimination remains at all times with the plaintiff.”¹⁰² Applying this formula to the instant case, the court concluded that “Bernauer, not Culver, should have been required to prove that but for retaliation her contract would not have been terminated.”¹⁰³ As the Commission had applied the wrong burden allocation formula to Culver and Bernauer, the court remanded the case to the ICRC for reconsideration in light of its ruling.¹⁰⁴

B. Scope of Preemption Under Civil Rights Acts

In *Fields v. Cummins Employees Federal Credit Union*,¹⁰⁵ the Fourth District Court of Appeals held that an employee’s tort claims against her employer for workplace sexual harassment were barred by the exclusive remedy provisions of the Indiana Workers’ Compensation Act.¹⁰⁶ However, the court refused to extend the exclusive remedy provisions of the Act, or the preemptive scope of either Title VII of the Civil Rights Act of 1964¹⁰⁷ or the Indiana Civil Rights Act,¹⁰⁸ to the employee’s common law claims against her supervisor.

This case arose after Cummins employee Sue Fields filed suit against her supervisor, Joseph Taylor, alleging that Taylor had subjected her to sexual harassment and battery and had intentionally interfered with her advantageous business relationship. Fields also filed suit against Cummins, her employer, alleging that Cummins knew of Taylor’s misconduct and had negligently retained Taylor as a supervisor. Both defendants moved for and were granted summary judgment by the Decatur County Circuit Court, and Fields appealed.

On appeal, Cummins argued, and the court agreed, that Fields’ cause of action was barred, as to Cummins, by the exclusive remedy provisions of the Indiana Workers’ Compensation Act.¹⁰⁹ In reaching this decision, the court relied upon the Indiana Supreme Court’s decision in *Evans v. Yankeetown Dock Corp.*,¹¹⁰ which held that the statutory prerequisites for bringing a workplace injury under the scope of the Indiana Workers’ Compensation Act were: (1) personal injury or death

102. *Culver*, 535 N.E.2d at 115.

103. *Id.* at 116.

104. *Id.*

105. 540 N.E.2d 631 (Ind. Ct. App. 1989).

106. *Id.*; See IND. CODE ANN. § 22-3-2-1 (Burns Supp. 1989).

107. 42 U.S.C. § 2000e (1978).

108. IND. CODE ANN. § 22-9-1-1 (Burns Supp. 1989).

109. *Fields*, 540 N.E.2d at 636. See also IND. CODE ANN. § 22-3-2-1 (Burns Supp. 1989).

110. 491 N.E.2d 969 (Ind. 1986).

by accident; (2) personal injury or death arising out of employment; and (3) personal injury or death arising in the course of employment.¹¹¹ In deciding that Fields' injury met all three of these statutory prerequisites, the court rejected the argument that her injury had not occurred "by accident" because the repeated nature of Taylor's harassing actions caused them to lose their "unexpected," and therefore their "accidental," character.¹¹² The court held that an employee's injury need not result from a single occurrence in order for it to be considered "accidental" under the Act.¹¹³

Turning to the Act's second statutory prerequisite, the court rejected Fields' arguments based on the doctrines of "respondent superior" and "negligent retention," finding that her claims were, by definition, predicated upon a causal connection between her alleged injuries and her employment relationship, and therefore arose "out of employment."¹¹⁴ The court reasoned that Fields' argument that her claims should be removed from the Act's coverage by the doctrine of respondeat superior must fail because, "[i]f Taylor was acting within the scope of his employment, [Fields'] injur[ies] would, by definition, arise out of the employment, while, if [Taylor] was not [acting within the scope of his employment,] the doctrine of respondeat superior would not apply and Cummins would [still] not be liable for his acts."¹¹⁵ Fields' argument that her claims should be removed from the Act's coverage by the doctrine of negligent retention fared no better, as the court noted that the use of this doctrine was premised on Cummins' negligence in the employment relationship, and that Field's injuries must, therefore, still arise "out of employment."¹¹⁶ Finally, as Fields did not contend that her injuries did not arise "in the course of employment," the court found that this third statutory prerequisite to coverage under the Act was also satisfied. For these reasons, the court affirmed the summary judgment in favor of Cummins, and held that a claim under the Workers' Compensation Act was Fields' exclusive remedy against her employer.¹¹⁷

111. *Id.* at 973.

112. *Fields*, 540 N.E.2d at 634.

113. *Id.* (citing *Hansen v. Von Duprin, Inc.*, 507 N.E.2d 573 (Ind. 1987)). In *Hanson*, an employee's anxieties caused by her supervisor's practical jokes were found to constitute an injury caused "by accident," despite the repeated nature of the supervisor's misconduct. 507 N.E.2d at 634.

114. *Fields*, 540 N.E.2d at 635.

115. *Id.* at 636.

116. *Id.*

117. Fields also claimed that her cause of action against Cummins should not be barred by the exclusivity provisions of the Indiana Workers' Compensation Act because she did not receive the "quid pro quo" which comprises the rationale for workers' compensation, in that Cummins did not pay any of her medical bills nor file a claim on

In his separate defense to Fields' claims, Taylor also relied on the Workers' Compensation Act, arguing that, because he was in the same employ as Fields, he should be immune from suit under the exclusive remedy provisions of that Act.¹¹⁸ However, the court rejected this argument, holding that, even if Fields' claims met the jurisdictional prerequisites for coverage under the Act, Taylor was not thereby automatically immune from suit.¹¹⁹ Instead, the court held that Taylor would be able to invoke the Act's immunity provisions only if he had been "acting in the course of his employment"¹²⁰ at the time Fields allegedly suffered her injuries. Finding it inconceivable that Taylor's alleged acts were for the benefit of his employer, the court held that those acts did not arise "out of employment" and that Taylor was therefore not immune from suit.¹²¹

Taylor next argued that, even if he could not avail himself of the Act's exclusive remedy provisions, Fields' common law claims were still preempted by Title VII of the Civil Rights Act of 1964 or by the Indiana Civil Rights Act, and that her claims had been extinguished by her failure to follow the administrative requirements of those Acts. The court disagreed. As for Taylor's argument under Title VII, the court found that it was "based on the mistaken notion that Fields has no common law right to be free from the acts committed by him and that workers were 'fair game' for sexual harassment until the passage of Title VII."¹²² Quoting from *Alexander v. Gardner-Denver*,¹²³ where the United States Supreme Court stated that "the legislative history of Title VII manifests a congressional intent to allow an individual to pursue independently his rights under both Title VII and other applicable state and federal statutes,"¹²⁴ the court concluded that Fields' Title VII rights were independent of her rights under state common law and that she was under no obligation to comply with Title VII's statutory procedures before she was eligible to obtain relief under Indiana common law.¹²⁵

Turning to Taylor's state law preemption argument, the court agreed, in *dicta*, that if Fields' common law claims had been "only for dis-

her behalf. The court rejected this argument, finding that the question was not whether an employee received compensation, but whether the jurisdictional prerequisites to coverage under the Act had been met. *Fields*, 540 N.E.2d at 637.

118. *Id.* at 637.

119. *Id.*

120. *Id.*

121. *Id.* at 638.

122. *Id.*

123. 415 U.S. 36 (1974).

124. *Fields*, 540 N.E.2d at 638 (quoting *Gardner-Denver*, 415 U.S. at 48-49).

125. *Id.* at 639.

crimatory actions arising from the sexual harassment”¹²⁶ she had experienced in the workplace, had involved facts *identical* to those needed to establish a claim for sexual harassment under the Indiana Civil Rights Act, and had involved remedies *identical* to those available under the Act, Taylor’s argument “would be well taken.”¹²⁷ However, as Fields’ common law claims required the proof of facts in addition to those needed to show discrimination under the Indiana Civil Rights Act and could be remedied by the awarding of damages not available under that Act, the court concluded that Fields’ common law claims were not preempted by the Act.¹²⁸ As she had not chosen to seek relief under the Indiana Civil Rights Act, the court also held that Fields was not required to comply with that Act’s administrative procedures before she was eligible to obtain relief under Indiana common law.¹²⁹ For these reasons, the court reversed the summary judgment in favor of Taylor and remanded the case for further proceedings in accordance with its opinion.¹³⁰

C. Handicap Discrimination Under Indiana Law

This survey period also saw a case of first impression decided by an Indiana court on the scope of an employer’s obligations to its handicapped employees under the Indiana Civil Rights Act. *Indiana Civil Rights Commission v. Southern Indiana Gas & Electric Co.*¹³¹ arose after job applicant N. June Leslie filed an employment application with Southern Indiana Gas & Electric Company (“SIGECO”) for a job as a “meter man.” Leslie was a 5’1” female weighing 124 pounds. The “meter man” job position for which she applied required heavy lifting on a daily basis. As part of its general practice, SIGECO’s company doctor, a general practitioner, gave Leslie a pre-employment physical examination. As a result of this examination, this doctor determined that Leslie had a lower back condition known as the sacralization of the L-5 vertebra, which rendered her unfit for heavy lifting. Based solely on this medical opinion, SIGECO did not hire Leslie to fill its “meter man” job position.

After obtaining a second medical opinion from a specialist in orthopedics, which opinion stated that Leslie’s medical condition would cause her no greater problems than someone with a “normal” back,

126. *Id.* at 640.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.* at 641.

131. 544 N.E.2d 536 (Ind. Ct. App. 1989).

Leslie filed a handicap discrimination claim with the Indiana Civil Rights Commission. In her claim, Leslie contended that she was a victim of handicap discrimination because her back condition did not prevent her from safely and efficiently performing the job duties of a "meter man." The ICRC agreed, and ordered SIGECO to employ Leslie, with back pay. SIGECO challenged this administrative decision, and the Pike County Circuit Court found in SIGECO's favor, reversing the Commission's determination that Leslie was a victim of handicap discrimination. Leslie and the ICRC then appealed this decision to the Fourth District Court of Appeals, which reversed again and found in Leslie's favor.

In ordering the Commission's order reinstated, the Fourth District Court of Appeals initially determined that Leslie had conclusively proven before the Commission that her back condition did not hinder her ability to safely and efficiently perform the job duties of a "meter man," despite SIGECO's medical opinion to the contrary. The court then considered, and rejected, SIGECO's argument that, as Leslie had admitted that she was not "handicapped," she was barred from bringing a handicapped discrimination action under the Indiana Civil Rights Act. In so doing, the court held that the Act, by its terms, was to be liberally and broadly interpreted in order to effectuate its purpose, and that persons who are discriminated against because they are "perceived as having handicaps" are protected by the Act even if they, in fact, are not "handicapped."¹³² The court then rejected SIGECO's argument that its "good faith reliance" on its doctor's opinion that Leslie was unfit for heavy lifting relieved it of any liability.¹³³ Ignoring Judge Conover's strong dissent that its holding required employers to act as "insurers" of the correctness of their experts' opinions,¹³⁴ the court held that the suffering caused to job applicants by even innocently perpetrated handicap discrimination was not mitigated by an employer's good faith, and that the Act imposed an affirmative duty upon employers to reassess employment decisions based on challenged medical diagnoses.¹³⁵

V. SUMMARY

The survey period saw several significant developments in Indiana labor law. First, the federal district court's decision in *Spearman v. Delco Remy Division of General Motors*¹³⁶ authorized the application of the doctrine of collateral estoppel based upon administrative decisions

132. *Id.* at 539-40.

133. *Id.* at 540.

134. *Id.* at 542 (Conover, J., dissenting).

135. *Id.* at 541.

136. 717 F. Supp. 1351 (S.D. Ind. 1989).

of the Indiana Employment Security Division in cases where the parties involved were represented by counsel and fully litigated at earlier administrative hearings the issues sought to be barred from relitigation.¹³⁷

Second, in *Meulen v. Review Board of Indiana Employment Security Division*¹³⁸ and *Voss v. Review Board Department of Employment & Training Services*,¹³⁹ respectively, the Second District Court of Appeals refused to limit the scope of statutory "just cause" by requiring employers to prove employee's "deliberately" violated their work rules¹⁴⁰ or that such violations were not "reasonable" under the circumstances.¹⁴¹ In *Beene v. Review Board of Indiana Department of Employment & Training Services*,¹⁴² the Second District Court of Appeals also found "no-fault" attendance policies to be "reasonable" work rules for unemployment eligibility purposes, as long as they allowed absences to "drop off" over time and provided safeguards for employees faced with long-term illnesses or special emergencies.¹⁴³

Third, in *Carter v. Review Board of Indiana Department of Employment & Training Services*¹⁴⁴ and *Stanley v. Review Board of Department of Employment & Training Services*,¹⁴⁵ respectively, the First District Court of Appeals refused, on due process grounds, to allow the Review Board of the Indiana Employment Security Division to either summarily dismiss claims of inadequate notice¹⁴⁶ or reverse eligibility determinations based solely on witness credibility.¹⁴⁷ Moreover, in *Winder v. Review Board of Indiana Employment Security Division*,¹⁴⁸ the Second District Court of Appeals held that equal protection of law requirements prevented the Review Board from applying the Indiana Employment Security Act so as to deny unemployment benefits to claimants who voluntarily quit one job and then involuntarily lose another while awarding such benefits to claimants who involuntarily lose their only job.¹⁴⁹

Fourth, courts in Indiana continued to utilize an "impasse" standard in determining whether claimants were unemployed due to a "labor dispute" and therefore statutorily ineligible for unemployment benefits.

137. *Id.* at 1357-60.

138. 527 N.E.2d 729 (Ind. Ct. App. 1988).

139. 533 N.E.2d 1020 (Ind. Ct. App. 1989).

140. *Meulen*, 527 N.E.2d at 730.

141. *Voss*, 533 N.E.2d at 1022.

142. 528 N.E.2d 842 (Ind. Ct. App. 1988).

143. *Id.* at 845-46.

144. 526 N.E.2d 717 (Ind. Ct. App. 1988).

145. 528 N.E.2d 811 (Ind. Ct. App. 1988).

146. *Carter*, 526 N.E.2d at 718-19.

147. *Stanley*, 528 N.E.2d at 813-15.

148. 528 N.E.2d 854 (Ind. Ct. App. 1988).

149. *Id.* at 857.

In *USS, A Division of USX Corporation v. Review Board of Indiana Employment Security Division*,¹⁵⁰ the Fourth District Court of Appeals refused to replace this standard with a broader "any controversy" standard.¹⁵¹ Moreover, in *Hehr v. Review Board of Indiana Employment Security Division*,¹⁵² the Second District Court of Appeals limited the circumstances in which picket line misconduct could be used to justify the "just cause" discharge of striking employees, by holding that claimants hitting vehicles crossing a picket line with their hands did not breach a duty owed their employers—absent proof of actual damage, the violation of a work rule, or evidence that the force of their blows would be likely to cause damage.¹⁵³ Finally, in *Green Ridge Mining v. Indiana Unemployment Insurance Board*,¹⁵⁴ the First District Court of Appeals refused to consider payments made pursuant to a written settlement agreement, but not specifically designated as "back pay," as income statutorily deductible from a claimant's unemployment benefit payments.¹⁵⁵

Fifth, this survey period saw changes in the law on workplace discrimination. In *Indiana Civil Rights Commission v. Culver*,¹⁵⁶ the Indiana Supreme Court specifically adopted the burden allocation formula used in federal courts for allocating burdens of proof in retaliation cases.¹⁵⁷ Under this formula, the ultimate burden of persuasion as to whether a defendant engaged in unlawful discrimination remains at all times with the plaintiff.¹⁵⁸ Moreover, in *Fields v. Cummins Employees Federal Credit Union*,¹⁵⁹ the Fourth District Court of Appeals gave employers a new defense to claims of workplace sexual harassment by ruling that such claims are subject to the exclusive remedy provisions of the Indiana Workers' Compensation Act.¹⁶⁰ However, the court refused to summarily extend the scope of that Act, or the preemptive scope of either Title VII or the Indiana Civil Rights Act, to common law claims filed by employees against their workplace supervisors.¹⁶¹ The court also held that, in Indiana, the administrative requirements of the above civil rights acts need not be followed as a condition precedent to the filing

150. 527 N.E.2d 731 (Ind. Ct. App. 1988).

151. *Id.* at 737-38.

152. 534 N.E.2d 1122 (Ind. Ct. App. 1989).

153. *Id.* at 1127.

154. 541 N.E.2d 550 (Ind. Ct. App. 1989).

155. *Id.* at 552-53.

156. 535 N.E.2d 112 (Ind. 1989).

157. *Id.* at 116.

158. *Id.* at 115.

159. 540 N.E.2d 631 (Ind. Ct. App. 1989).

160. *Id.* at 637.

161. *Id.* at 638-40.

of a common law claim.¹⁶² Finally, in *Indiana Civil Rights Commission v. Southern Ind. Gas & Elec. Co.*,¹⁶³ the Fourth District Court of Appeals interpreted the Indiana Civil Rights Act as imposing an affirmative duty on employers to reassess employment decisions based on challenged medical opinions.¹⁶⁴

162. *Id.* at 640.

163. 544 N.E.2d 536 (Ind. Ct. App. 1989).

164. *Id.* at 540-41.

Survey of Recent Developments in Professional Responsibility

ROGER D. ERWIN*

I. INTRODUCTION

Several cases during the survey period are noteworthy. Some are of interest because they address issues under the Indiana Rules of Professional Conduct¹ ("Rules"), rather than the former Indiana Code of Professional Responsibility² ("Code"). Others deserve attention because they represent refinements of earlier cases or somewhat unique facts.

II. DISCUSSION

A. Ex Parte Contact

Rule 3.5 of the Indiana Rules of Professional Conduct speaks to permitted communications between a lawyer and a judge. Its operative terms are that a lawyer shall not "[c]ommunicate *ex parte* with [a judge] except as permitted by law."³

The Comment to Rule 3.5 emphasizes that a lawyer should be familiar with the Code of Judicial Conduct, which specifies other additional improper means of influencing a tribunal.⁴ A lawyer, as also noted in the Comment, is "required to avoid contributing to a violation of [the Code of Judicial Conduct]."⁵ Canon 3 of the Indiana Code of Judicial Conduct similarly provides that a judge, "except as authorized by law," may "neither initiate nor consider *ex parte* or other communications concerning a pending or impending proceeding."⁶

Although referencing Rules 1-102 (A)(1) and (5) of the former Indiana Code of Professional Responsibility and Canons 1, 2(A) and (B), and 3(A)(4) of the Indiana Code of Judicial Conduct, the Indiana Supreme

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1. INDIANA RULES OF PROFESSIONAL CONDUCT (1987) [hereinafter RULES OF PROF. CONDUCT].

2. INDIANA CODE OF PROFESSIONAL RESPONSIBILITY (1986).

3. RULES OF PROF. CONDUCT Rule 3.5.

4. *Id.* comment.

5. *Id.*

6. INDIANA CODE OF JUDICIAL CONDUCT Canon 3(A)(4) (1987).

Court's language in *In re Lewis*⁷ is useful in understanding Rule 3.5 of the current Indiana Rules of Professional Conduct. In *Lewis*, the respondent discussed the merits of various criminal cases in his chambers *ex parte*.⁸ The discussions generally were with friends or relatives of criminal defendants, and the conversations lent themselves to the suggestion that friends of the judge were favored in judicial proceedings.⁹

The court acknowledged *sub silentio* that *ex parte* contact is not flatly prohibited. When the line is crossed between procedure and merit, however, ethical concerns arise. The court suggested that the merits of a controversy might be discussed *ex parte* in justifiable circumstances.¹⁰ The Rules and the Code clearly allow *ex parte* contact when permitted by law,¹¹ but one can expect in future cases that this will not be the only exception recognized as "justifiable" by the court.

In any event, the respondent's conduct in *In re Lewis* obviously was without justification. The court's language in describing the test for permissible *ex parte* conduct and in applying the ethical concerns to the facts of this case, are illuminating:

Respondent's conduct was not limited to casual discourse with individuals concerned with matters then pending before Respondent. The Respondent freely and openly discussed the merits of the controversy in an atmosphere which is without justification in the professional resolution of disputes. Respondent was not an attorney serving as a judge, but conducted his judicial duties as a broker of favor.¹²

Former Disciplinary Rule 7-110(B) of the Code similarly provided that an attorney could not communicate, or cause another to communicate, regarding the merits of a case, with a judge, except in specific situations.¹³ Those situations included communication during an official proceeding; in writing (if a copy was promptly delivered to the adversary); orally (upon adequate notice to the adversary); or, as otherwise permitted by law or the Code of Judicial conduct.¹⁴

Under the Code, the term "merits" "has often been interpreted broadly to include matters that might *indirectly* affect how the judge

7. 535 N.E.2d 127 (Ind. 1989).

8. *Id.* at 128.

9. *Id.* at 128-29.

10. *Id.* at 129.

11. See, e.g., IND. R. TR. P. 65(b) (1987) (which provides for the issuance of a temporary restraining order without notice).

12. *Lewis*, 535 N.E.2d at 129.

13. INDIANA CODE OF PROFESSIONAL RESPONSIBILITY DR 7-110(B).

14. *Id.*

might ultimately rule.”¹⁵ It should also be realized that Rule 3.5 of the Indiana Rules of Professional Conduct does not specifically limit the prohibition against communication *ex parte* with a judge to the merits of a case. Indeed, it has been said that “[u]nder the Model Rules, *ex parte* communications are barred even if it is not clear that the lawyer intended to influence the Judge.”¹⁶

How far the Indiana Supreme Court will go in restricting *ex parte* contact is yet to be seen, but it would not seem workable to prevent contact on procedural matters which do not give one side of a controversy a substantial advantage in the proceeding. *In re Lewis* does not answer such questions; yet, the case is significant in that it does seem to clarify that *ex parte* contact is prohibited even if the other party is a non-lawyer (in which case the judge commits a violation of the ethics rules), and that a lawyer is subject to Rule 3.5 even if he does not represent a party to the action. Other cases have reached similar results: “A lawyer need not represent a party to a case to be subject to the Rule 3.5(b) proscription against *ex parte* communication. . . .”¹⁷ Nor need the lawyer make the improper communication directly as long as the lawyer instigates the communication.¹⁸

Professors Geoffrey Hazard and William Hodes have perhaps best described the rationale for the prohibition of Rule 3.5(b), which they rightly see as basic to the adversary system of justice:

The adversary system is based on the assumption that equals will meet in a fair contest before a neutral tribunal. Unauthorized *ex parte* contacts directly undermine the system, for they deprive the opposing party of an opportunity to respond. This is true

15. [1984] LAW. MANUAL OF PROFESSIONAL CONDUCT (ABA/BNA) 61:804 (emphasis added) [hereinafter LAWYER'S MANUAL].

16. *Id.*

17. *Id.* (citing Florida Bar v. Saphirstein, 376 So. 2d 7 (Fla. 1979) (lawyer who contacted referee in pending disciplinary matter involving another lawyer to influence referee's decision); Florida Bar v. Meson, 334 So. 2d 1 (Fla. 1976) (lawyer submitting *amicus* brief to supreme court improperly discussed case with justice during golf game and sent secret memorandum on main issue of case)).

18. LAWYER'S MANUAL at 61:804-05 (citing People v. Hertz, 638 P.2d 794 (Colo. 1982) (suggesting to principal witness in grievance proceeding that witness write letter to chief justice recanting testimony)). Compare Professional Ethics Commission of the Maine Board of Overseers of the Bar, Opinion 88, LAWYER'S MANUAL, *supra* note 15, at 901:4206 (Aug. 31, 1988) (no duty to inform opposing counsel that member of administrative tribunal sent unsolicited letter of support to client) with *In re Ragatz*, LAWYER'S MANUAL, *supra* note 15 (4 Current Reports 348) (Oct. 4, 1988) (60-day suspension for responding to conversation initiated by judge and replying by letter without providing a copy to opposing counsel).

even in the absence of bribery or other obviously improper conduct, which are prohibited. . . .¹⁹

One test for prohibited *ex parte* contact should be whether the contact likely prevented both parties from receiving neutral consideration on significant matters, whether procedural or substantive, and whether time constraints necessitated the *ex parte* contact. Any doubts should be resolved in favor of the unrepresented party. In *In re Lewis*, the respondent failed this test.

B. Criminal Acts, Conduct Prejudicial to the Administration of Justice and Disability

*In re Roche*²⁰ is significant,²¹ among other reasons, because the Indiana Supreme Court correctly noted that Rule 8.4(b) (committing a crime that reflects adversely on the honesty, trustworthiness or fitness as a lawyer in other respects) and 8.4(d) (engaging in conduct prejudicial to the administration of justice) "closely parallel the provisions of [former] Disciplinary Rule 1-102(A)(5) and (6) of the superseded *Code*."²² Accordingly, "the analysis of the conduct and the bounds of the professional standards under the *Code* are fully applicable under the provisions of the *Rules of Professional Conduct*."²³

Following the lead of *In re Jones*,²⁴ decided under the former Code, the court saw a nexus between the illegal possession of marijuana and fitness as an attorney. Thus, the *Roche* case presented a violation of Rule 8.4(b).²⁵ Following the lead of *In re Oliver*,²⁶ also decided under the former Code, the court observed that the arrest and conviction for illegal possession of marijuana while the respondent in *Roche* served as county prosecutor, constituted conduct prejudicial to the administration of justice, a violation of Rule 8.4(d).²⁷

The court underscored that, but for the "numerous mitigating circumstances,"²⁸ it would be inclined to impose a far more serious sanction

19. G. HAZARD & W. HODES, THE LAW OF LAWYERING 389-90 (1985 & Supp. 1989) [hereinafter THE LAW OF LAWYERING].

20. 540 N.E.2d 36 (Ind. 1989).

21. The author represented the respondent before the Indiana Supreme Court in *Roche*.

22. *Roche*, 540 N.E.2d at 38.

23. *Id.*

24. 515 N.E.2d 855 (Ind. 1987).

25. 540 N.E.2d at 38.

26. 493 N.E.2d 1237 (Ind. 1986).

27. 540 N.E.2d at 38.

28. *Id.*

than the agreed public reprimand.²⁹ Among the mitigating circumstances referenced by the court were exemplary conduct in that the respondent was a war hero; he had to undergo counseling in dealing with the trauma of war; he recently lost a child; he devoted extensive time to *pro bono* work; he devoted more time than expected to prosecutorial duties; he had enjoyed an excellent relationship with law enforcement personnel; he had never before been disciplined; he unhesitatingly cooperated with the disciplinary investigation; he accepted responsibility for the misconduct, and; he was genuinely remorseful.³⁰ The sanction imposed in this case should not be viewed as a departure from the rule of law previously announced by the court. Rather, *Roche* should be seen as a rejection of rigid sanctions and an acceptance of flexible sanctions based upon the totality of mitigating and other circumstances.

*In re Hudgins*³¹ dealt with disciplinary charges brought following an attorney's conviction for child molesting. The hearing officer, however, found that the misconduct did not involve an attorney-client relationship and that the respondent had effectively represented clients.³² Based upon psychiatric testimony, the hearing officer further concluded that the respondent engaged in misconduct, yet was not a danger to the public, courts or the profession.³³

The court noted a pattern of repeated molestation and easily found a violation of former Disciplinary Rule 1-102(A)(3) (commission of an act involving moral turpitude).³⁴ The only remaining issue was the appropriate sanction.

The court acknowledged that some jurisdictions have been somewhat lenient in imposing discipline, while others have imposed severe sanctions.³⁵ For example, in *In re Safran*,³⁶ and *In re Kimmel*,³⁷ attorneys were placed on disciplinary probation for sexual misconduct when there was a showing that repeated incidents were unlikely. The court rejected that approach and placed Indiana squarely within the group of courts imposing severe sanctions. Reminding that danger to the public is only one factor to consider in determining the appropriate sanction,³⁸ and over the dissents of Chief Justice Shephard and Associate Justice DeBruler,

29. *Id.*

30. *Id.* at 37.

31. 540 N.E.2d 1200 (1989).

32. *Id.* at 1201.

33. *Id.* at 1202.

34. See also RULES OF PROF. CONDUCT Rule 8.4(b) (1987).

35. *Hudgins*, 540 N.E.2d at 1201 (citing 43 A.L.R. 4th 1062 (1983)).

36. 18 Cal. 3d 134, 554 P.2d 329, 133 Cal. Rptr. 9 (1976).

37. 322 N.W.2d 224 (Minn. 1982).

38. 540 N.E.2d at 1202-03.

who would have imposed a lesser sanction, the respondent was disbarred.³⁹

Whether the result in this case would have differed under the Indiana Rules of Professional Conduct seems doubtful, but the court is in a period of transition, with new members joining the court. Different facts could see a different result. It should also be noted that the "moral turpitude" standard has been heavily criticized, and the standard of Rule 8.4(b) has been seen by some as a more lenient standard:

Commentators have also criticized the Model Code's reference to "moral turpitude" as inviting subjective judgments of diverse lifestyles instead of measuring a lawyer's ability and fitness to practice law. . . . Model Rule 8.4(b), by contrast, only reaches instances of criminal sexual misconduct or sexual exploitation of a nature indicating that the lawyer is unworthy of the confidence reposed in him or her.⁴⁰

In connection with disability, the majority pointed out that Section 25 of Admission and Discipline Rule 23 could not be invoked because the respondent did not suffer from "any disability by reason of mental illness or infirmity, or because of the use of or addiction to intoxicants or drugs. . . ."⁴¹ Instead, expert testimony was to the effect that the respondent was aware of the nature and quality of his conduct and, moreover, it could not be guaranteed that he would not again molest children. Beyond this, disbarment was seen as necessary, in the majority's view, because of the impact such conduct would have on the public's perception of the respondent's fitness to practice law.⁴²

Similarly, in terms of the disability issue, in *In re Powell*,⁴³ a pivotal factor was that the attorney did know right from wrong.⁴⁴ There, the attorney misrepresented the status of cases, required releases exonerating him from malpractice liability and converted client funds for personal use. In defense, it was claimed that the respondent was depressed and,

39. *Id.* at 1203.

40. LAWYER'S MANUAL, *supra* note 15, at 101:303-04. After this article was written, the Indiana Supreme Court handed down its decision in *In re Kern*, 551 N.E.2d 457 (Ind. 1990), in which the Respondent was given a two-year suspension following his plea of guilty to child molesting under IND. CODE § 35-50-2-7(b), involving the fondling of a girl 15 years and 11 months old. The Court effectively announced that child molesting *per se* constitutes unfitness to practice law under Rule 8.4(b) and warrants suspension or disbarment. Suspension, rather than disbarment, was evident in view of the fact that the child's age was unknown to the Respondent, while he did know that she was the mother of a child more than one year old.

41. *Hudgins*, 540 N.E.2d at 1202-03.

42. *Id.* at 1202.

43. 526 N.E.2d 971 (Ind. 1988).

44. *Id.* at 973.

therefore, disabled. Rejecting that contention, it was concluded that the respondent was not disabled at the time of the misconduct.⁴⁵ The court consciously sidestepped the issue of whether a serious disability would serve as a complete defense or as a mitigating factor and found that the respondent violated Indiana Code section 35-43-4-3, and Disciplinary Rules 1-102(A)(4), (5) and (6); 6-102(A); 7-101(A)(3); and, 9-102(A) and (B)(1), and disbarred the respondent.⁴⁶ Such conduct might now be seen as a violation of current Rules 1.4, 1.5, 1.8, 1.15 and 8.4.

C. Permissive Withdrawal of Representation

Two cases during the survey period addressed the issue of under what circumstances an attorney may voluntarily withdraw his representation of a client.

In *Conn v. State*,⁴⁷ the Indiana Supreme Court entertained an appeal from a defendant convicted of dealing in a controlled substance. One week before trial, the trial court conducted a hearing upon a request by one of the appellant's lawyers to withdraw from the case. The request was based upon the fact that counsel was himself a party to a dissolution action set for hearing in another court on the same day as his client's scheduled trial date.⁴⁸

The court heard from counsel that each was prepared and heard from the appellant that he objected, wanting both to appear. When pressed by the court to articulate a more specific reason for his objection, the appellant stated that he needed time to inform the counsel who would stay on the case about some matters previously disclosed only to the counsel who would withdraw. The court noted the opportunity remaining to the defense to complete further preparation for trial and granted counsel leave to withdraw.⁴⁹

In ruling on the propriety of the trial court's granting of leave to withdraw, the court considered the applicability of Disciplinary Rule 2-110.⁵⁰ In upholding the trial court's granting of the motion to withdraw, the court noted that co-counsel was already in a state of readiness, with an additional week left for further preparation, and that co-counsel had in fact conducted himself at trial in a skilled and active fashion.⁵¹ The court held that the appellant's right to legal representation was fully

45. *Id.*

46. *Id.* at 973-74.

47. 535 N.E.2d 1176 (Ind. 1989).

48. *Id.* at 1181.

49. *Id.*

50. *Id.*

51. *Id.*

protected, and the cause given by counsel in support of his request to withdraw satisfied Disciplinary Rule 2-110(C)(4), allowing withdrawal where a physical or mental condition makes it difficult to effectively represent a client, and Indiana Code section 35-36-8-2(b)(5), which sanctions withdrawal upon manifest necessity.⁵²

As previously noted, Disciplinary Rule 2-110(C)(4) is no longer applicable; while there is no precise corollary rule to Disciplinary Rule 2-110, the applicable rule under the factual situation of *Conn* would appear to be Rule 1.16(b)(6).⁵³ This rule provides that a lawyer may withdraw from representing a client if withdrawal can be accomplished without material adverse effect on the interests of the client *or* if "other good cause for withdrawal exists."⁵⁴ Presumably, a conflicting trial date under the circumstances set forth in *Conn* would constitute sufficient good cause for purposes of Rule 1.16. An attorney, even then, must exercise sound judgment in determining in which case he should seek leave to withdraw.

Client consent is not expressly required, but the attorney is subject to Rule 1.16(c), which provides that a tribunal may order continued representation notwithstanding good cause for terminating the representation.⁵⁵ In addition, caution is urged in withdrawing because Rule 1.16(b)(6) does not permit withdrawal when the client will be materially and adversely affected except upon a showing of "good cause."

In *Flowers v. State*,⁵⁶ the appellant sought to withdraw his guilty plea at the sentencing hearing, at which time his counsel moved to withdraw from the case pursuant to Disciplinary Rule 2-110 due to a conflict of interest. The trial court did not permit counsel to withdraw, and the Indiana Supreme Court upheld the trial court's denial of the attorney's motion to withdraw, apparently based upon the conclusion that such a withdrawal would result in a delay of the administration of justice.⁵⁷ Unfortunately, the case does not divulge the nature of the alleged conflict of interest.

In upholding the trial court's denial of counsel's motion to withdraw, the court stated merely that whether to allow counsel to withdraw is a matter of trial court discretion.⁵⁸ Of course, counsel is obliged to continue representation under Rule 1.16(c) when so ordered by a trial court.

52. *Id.* at 1182.

53. RULES OF PROF. CONDUCT Rule 1.16(b) (1987).

54. *Id.*

55. See LAWYER'S MANUAL, *supra* note 15, at 31:1101.

56. 528 N.E.2d 57 (Ind. 1988).

57. *Id.* at 59.

58. *Id.*

D. Misappropriation of Client Funds

In *Matter of Bryant*,⁵⁹ a client was forced to sue his attorney for the purpose of recovering a settlement fee which had been obtained by the attorney and deposited by the attorney in his own bank account. The respondent did eventually pay his client the recovered amount, but only after the client had obtained a judgment against the respondent nearly one year after the negotiation of the settlement.

The Indiana Supreme Court determined that the respondent engaged in conduct involving deceit and misrepresentation, which adversely reflected on his fitness to practice law, in violation of Disciplinary Rule 1-102(A)(3) (providing that a lawyer shall not engage in illegal conduct involving moral turpitude), Disciplinary Rule 1-102(A)(4) (which prohibits a lawyer from engaging in conduct involving dishonesty, fraud, deceit or misrepresentation), and Disciplinary Rule 1-102(A)(6) (prohibiting a lawyer from engaging in any other conduct that adversely reflects on his fitness to practice law).⁶⁰ The court further found that the failure to render and appropriately account or promptly pay over to the client the funds, as requested by the client, violated Disciplinary Rule 9-102 (B)(3) and (4), which require an attorney to maintain complete records of all client funds and to promptly pay to the client, as requested by the client, the funds which the client is entitled to receive.⁶¹ Rules currently implicated would include Rules 1.4, 1.5, 1.15, 4.1 and 8.4.

E. Frivolous Causes of Action

A recent Indiana case will undoubtedly have an impact on attorneys who bring frivolous or groundless causes of action. In *Kahn v. Cundiff*,⁶² the attorney was required by the Court of Appeals for the First District of Indiana to pay the attorney fees incurred by one of the original defendants in the action who was dismissed from the action immediately prior to trial.

A brief review of the facts surrounding the initial complaint filed by Kahn is helpful in ascertaining the significance of the imposition of attorney fees against him. On September 19, 1985, Rachel Cundiff was driving a vehicle owned by her husband, Larry Cundiff. Rachel collided with another vehicle and injured its passengers, Paulette Brown and Terry Willis.

On December 1, 1986, the attorney filed a complaint on behalf of Brown and Willis against both Rachel and Larry. The complaint alleged

59. 524 N.E.2d 1288 (Ind. 1988).

60. *Id.* at 1290.

61. *Id.*

62. 533 N.E.2d 164 (Ind. 1989).

that Rachel negligently operated a vehicle owned by Larry and caused injury to Brown and Willis. The theory of Larry's liability put forth by the attorney was apparently based upon either negligent entrustment or vicarious liability.⁶³

On June 16, 1987, prior to selection of the jury, the attorney for Brown and Willis admitted that he had no facts to support a claim against Larry; accordingly, the trial court dismissed Larry from the case.⁶⁴ Thereafter, Larry filed a request for attorney fees pursuant to Indiana Code section 34-1-32-1, providing for the award of attorney fees to defendants who are made the subject of a frivolous, unreasonable or groundless cause of action.⁶⁵ Subsequently, the trial court granted Larry's request for attorney fees and ordered Brown and Willis' attorney to pay Larry \$8,246.65 in attorney fees and \$411.11 for jury costs in connection with the filing of an action which was frivolous, unreasonable or groundless.⁶⁶

In upholding the trial court's award of attorney fees to Larry (although the appellate court reversed the trial court's award of attorney fees with regard to the amount and remanded the case for a hearing as to reasonable attorney fees), the appellate court emphasized the trial court's finding that at no time during the entire lawsuit was the attorney ever able to produce *any* evidence that Larry should be a party to the lawsuit.⁶⁷

Indiana Code section 34-1-32-1 provides in relevant part:

- (b) In any civil action, the court may award attorney's fees as part of the cost to the prevailing party, if it finds that either party:
 - (1) *brought the action* or defense on a claim or defense that is *frivolous, unreasonable, or groundless*;
 - (2) *continued to litigate* the action or defense after the party's claim or defense clearly became frivolous, unreasonable, or groundless; or
 - (3) litigated the action in bad faith . . .⁶⁸

In determining the propriety of the award of attorney fees under Indiana Code section 34-1-32-1, the court attempted to define the statutory terms "frivolous, unreasonable or groundless."⁶⁹ In so doing, the

63. *Id.* at 168.

64. *Id.* at 166.

65. *Id.*

66. *Id.*

67. *Id.* at 167.

68. IND. CODE § 34-1-32-1 (1988) (emphasis added).

69. *Kahn*, 533 N.E.2d at 170.

court looked to Rule 3.1 of the Indiana Rules of Professional Conduct for guidance in defining the term "frivolous."⁷⁰ Rule 3.1 provides in relevant part: "A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."⁷¹ Based on the comments to Rule 3.1 and an examination of case law from other jurisdictions, the court concluded that a claim or defense is "frivolous"

- (a) if it is taken primarily for the purpose of harassing or maliciously injuring a person, or (b) if the lawyer is unable to make a good faith and rational argument on the merits of the action, or (c) if the lawyer is unable to support the action taken by a good faith and rational argument for an extension, modification, or reversal of existing law.⁷²

The court went on to hold that "a claim or defense is unreasonable if, based on a totality of the circumstances, including the law and facts known at the time of the filing, no reasonable attorney would consider that the claim or defense was worthy of litigation or justified."⁷³ Finally, the court held that "a claim or defense is groundless if no facts exist which support the legal claim relied on and presented by the losing party."⁷⁴

The absence of facts to support the attorney's claims of negligent entrustment and vicarious liability, combined with the court's stated definitions of "frivolous, unreasonable and groundless," led the appellate court to agree with the trial court's legal conclusion that Kahn's claim was frivolous, unreasonable or groundless.⁷⁵

Kahn is of particular interest in that in order to determine the definition of "frivolous" for purposes of Indiana Code section 34-1-32-1, the court looked to Rule 3.1 of the Indiana Rules of Professional Conduct for guidance. Rule 3.1 also provides guidance as to what is *not* "frivolous." The comments to Rule 3.1 state that an action "is not frivolous merely because the facts have not been fully substantiated or because the lawyer expects to develop vital evidence only by discovery. Such action is not frivolous even though the lawyer believes that the client's position ultimately will not prevail."⁷⁶ The action is frivolous,

70. *Id.*

71. RULES OF PROF. CONDUCT Rule 3.1 (1987).

72. *Kahn*, 533 N.E.2d at 170.

73. *Id.* at 170-71.

74. *Id.* at 171.

75. *Id.*

76. RULES OF PROF. CONDUCT Rule 3.1 comment (1987).

according to the comment, if taken primarily to harass or maliciously injure or if the attorney cannot make a good faith argument for extension, modification or reversal of existing law.⁷⁷

A brief history of the adoption of Rule 3.1 perhaps places these decisions in context and makes clear that Rule 3.1 changes the guidelines under the former Code of Professional Responsibility to require a reasonable basis for the action, with an objective standard, but with an exception in criminal cases whereby the prosecution may be put to its proof regardless of whether there is a reasonable basis for the defense:

When it drafted Model Rule 3.1, the ABA Commission on Evaluation of Professional Standards explained the relationship of the proposed rule to the Code's disciplinary rules that it replaced:

Rule 3.1 is to the same general effect as DR 7-102(A)(1), with three qualifications. First, the test of improper conduct is changed from 'merely to harass or maliciously injure another' to the requirement that there be 'reasonable basis for' the litigation measure involved. This includes the concept stated in DR 1-102(A)(2) that a lawyer may advance a claim or defense unwarranted by existing law if 'it can be supported by good faith argument for an extension, modification, or reversal of existing law.' Second, the test in Rule 3.1 is an objective test, whereas DR 7-102(A)(1) applies only if the lawyer 'knows or when it is obvious' that the litigation is frivolous. Third, Rule 3.1 has an exception that in a criminal case, or a case in which incarceration of the client may result (for example, certain juvenile proceedings), the lawyer may put the prosecution to its proof even if there is no 'reasonable basis' for defense." ABA, Proposed Final Draft, Model Rules of Professional Conduct at 121 (1981). The reporter for the commission noted at the ABA's 1983 midyear meeting that "[a] 'not frivolous' standard was adopted rather than one based on the concepts 'harass' or 'maliciously injure,' to track the standard generally used and defined in the law of procedure." ABA, *The Legislative History of the Model Rules of Professional Conduct: Their Development in the ABA House of Delegates* at 119 (1987). The ABA House of Delegates adopted the proposed rule without change.⁷⁸

F. Disclosure and Candor to Tribunals, Dishonesty, Deceit and Misrepresentation

Several recent Indiana decisions have focused on an attorney's duty of candor and disclosure to tribunals, as well as a general duty to refrain from misrepresenting facts and the law to the court.

77. *Id.*

78. LAWYER'S MANUAL, *supra* note 15, at 61:104.

In *In re Rajan*,⁷⁹ the Indiana Supreme Court held that a deliberate misrepresentation of certain matters to a government agency in connection with an application submitted for employment with the Pension Benefit Guaranty Corporation ("PBGC"), warranted a one year suspension from the practice of law.⁸⁰ In this case, the respondent submitted an application with PBGC that falsified his date of birth and the period during which he attended undergraduate and graduate school, both in India and the United States.⁸¹ Each of the misrepresentations of fact was submitted willfully to PBGC, with knowledge of its falsity and with the intent to deceive that agency as to his true age, which was five years older than the representation on the application.⁸² These acts constituted a violation of United States Code section 1001, which makes it a violation to make misrepresentations with regard to any matter within the jurisdiction of any department or agency of the United States.

The court concluded that the respondent engaged in illegal conduct involving moral turpitude; conduct involving dishonesty, fraud, deceit or misrepresentation; and, conduct which adversely reflected on his fitness to practice in violation of Disciplinary Rules 1-102(A)(3), (4) and (6) of the Code of Professional Responsibility.⁸³ Current rules implicated would include Rules 4.1 and 8.4.

In *Nehi Beverage Co. v. Petri*,⁸⁴ a beverage company sought to appeal a judgment entered against it in an action to recover the value of services and goods received. However, while the appeal was pending, Nehi filed a petition in bankruptcy, thereby precluding consideration of any issues as they related to Nehi pursuant to the automatic stay provision of Title 11 of the United States Code, section 362(a)(1).⁸⁵ Only after significant prodding by the court (in the course of its review of the record, the court stumbled across facts suggesting that a bankruptcy petition had indeed been filed by Nehi) did counsel for Nehi inform the court of the bankruptcy petition. The court noted that regardless of whether such failure was deliberate or merely the result of negligence, counsel had breached his professional responsibility to the court.⁸⁶

His inaction in this regard required us to assume the role of judicial "detective" to ferret out the truth of this matter, expending in the process an enormous amount of judicial time in

79. 526 N.E.2d 1185 (Ind. 1988).

80. *Id.* at 1186.

81. *Id.*

82. *Id.*

83. *Id.*

84. 537 N.E.2d 78 (Ind. 1988).

85. *Id.* at 80 n.1.

86. *Id.*

that pursuit to the detriment of litigants whose appeals also pend here. We direct Richards' attention to the provisions of Rules of Professional Conduct, Rule 3.1, Meritorious Claims and Contentions, Rule 3.3, Candor Toward the Tribunal, and Rule 3.5, Impartiality and Decorum of the Tribunal, subsection (c).⁸⁷

While conceding Richards may not have violated the letter of these rules so as to warrant disciplinary proceedings, the court stated that Richards had unquestionably violated their spirit by his inaction in disclosing the filed bankruptcy petition.⁸⁸

However, in *In re Paternity of K.G.*,⁸⁹ a paternity action brought by the state against one "R.A.F." for the purpose of determining the father of one "K.G.," the Indiana Court of Appeals recognized limits on a defense attorney's duty to clarify the record for the state. During the deposition of one Dr. Sand on direct examination, the state asked Sand if he delivered a child bearing a name different from K.G.; that is, the question was whether he delivered "C.G.," *not* K.G. As a result, the court reversed the trial court's denial of R.A.F.'s motion to strike the testimony as it related to the birth of C.G. on the grounds that it was irrelevant for purposes of determining the paternity of K.G.⁹⁰ In holding that the motion to strike was timely made, the court noted that R.A.F.'s counsel was under no duty to prove the state's case, citing Rules 3.1 and 3.3 of the Rules of Professional Conduct in support of its position.⁹¹

In *In re Brown*,⁹² the Indiana Supreme Court held that preparation and submission of knowingly false documents in an administrative proceeding before the Social Security Administration warranted a one year suspension from the practice of law. In this case the respondent was charged with knowingly using false evidence, knowingly making a false statement of law or fact, and participating in the creation or preservation of evidence she knew was false or evidence that was obviously false in violation of Disciplinary Rules 7-102(a)(4), (5), and (6); engaging in conduct involving dishonesty, fraud, deceit or misrepresentation in violation of Disciplinary Rule 1-102(A)(4); engaging in conduct that adversely reflected on her fitness to practice law in violation of Disciplinary Rule 1-102(A)(6), and finally; neglecting a legal matter entrusted to her in violation of Disciplinary Rule 6-101(A)(3).⁹³

87. *Id.*

88. *Id.*

89. 536 N.E.2d 1033 (Ind. Ct. App. 1989).

90. *Id.* at 1036-37.

91. *Id.* at 1036.

92. 524 N.E.2d 1291 (Ind. 1988).

93. *Id.* at 1291.

The alleged misconduct emanated from respondent's representation of individuals in proceedings before the United States Social Security Administration, Department of Health and Human Services ("HHS"). The respondent was employed to represent an individual on a request for reconsideration of disability benefits before the HHS, but the request for reconsideration was denied. A request for hearing was due to be filed on or before April 23, 1983, but the request was not filed. Thereafter, the respondent was advised that the request for hearing could be submitted on or before May 10, 1983. However, the respondent failed to meet this deadline as well.

On May 12, 1983, the respondent submitted to the HHS a request for hearing form which purportedly had been submitted on or about April 13, 1983, and officially acknowledged by HHS on that date. This acknowledgment was purportedly signed by "D. Redman," an HHS employee; yet, the request for hearing form had not been submitted, acknowledged or signed as represented by the respondent.⁹⁴ At the time the form was submitted, the respondent was fully aware of the misrepresentations.⁹⁵

Based on these facts, the court concluded that the respondent violated the Code of Professional Responsibility as charged and imposed a sanction of suspension for one year.⁹⁶ The preparation and submission of knowingly false documents in an administrative proceeding before the HHS was held to constitute the use of false evidence, the making of a false statement and the creation of evidence known to be false:⁹⁷

[T]his conduct violates Disciplinary Rules 7-102(A)(4), (5), and (6). This obvious misrepresentation also violates Disciplinary Rule 1-102(A)(4) and demonstrates conduct which adversely reflects on Respondent's fitness to practice law in violation of Disciplinary Rule 1-102(A)(6). The motivation for this misconduct was Respondent's failure to timely submit requisite pleadings on behalf of her clients. This failure to accomplish the ends of representation, accordingly, also demonstrates an underlying neglect which violates Disciplinary Rule 6-101(A)(3).⁹⁸

Current ethics rules which might have been violated under these facts include Rules 1.3, 1.4, 3.1, 3.2, 3.3, 3.4, 4.1 and 8.4.

Finally, in *In re Sheaffer*,⁹⁹ the Indiana Supreme Court held that an attorney's seeking out of a material witness in a criminal investigation

94. *Id.* at 1292.

95. *Id.*

96. *Id.* at 1292-93.

97. *Id.* at 1292.

98. *Id.*

99. 531 N.E.2d 495 (Ind. 1988).

against his client, and counseling him to conceal their interview from the investigating officer and alter statements he had already given the officer, warranted a suspension from the practice of law for a period of not less than two years.¹⁰⁰

In this case, the court concluded that the respondent's attempt to alter the testimony of a material witness against his client constituted conduct which involved dishonesty, deceit and misrepresentation in violation of Disciplinary Rule 1-102(A)(4) of the Code of Professional Responsibility.¹⁰¹ Further, by counseling the witness to lie about their meeting, and to change his statement to the investigating officer, the respondent participated in the creation and preservation of evidence when it was obvious that the evidence was false, in violation of Disciplinary Rule 7-102(A)(6).¹⁰² Finally, the court concluded that such conduct was prejudicial to the administration of justice and adversely reflected on the respondent's fitness to practice law, in violation of Disciplinary Rule 1-102(A)(5) and (6).¹⁰³

100. *Id.* at 498.

101. *Id.* at 497.

102. *Id.* at 498.

103. *Id.*

Survey of Recent Developments in Property Law

WALTER W. KRIEGER*

I. BROKERS: COMMISSION ON EXERCISE OF OPTION TO PURCHASE

In a case of first impression, the Indiana Court of Appeals, in *Estate of Saemann v. Tucker Realty*,¹ held that a real estate broker was not entitled to a commission on a sale of land which results from the exercise of an option to purchase agreement negotiated during the period of the listing agreement, but exercised after the time for performance under the listing agreement had expired. In *Saemann*, Tucker Realty had entered into an exclusive listing agreement to sell Saemann's 202.5 acre farm in Kosciusko County, Indiana, known as "City Edge Farm." The period of the exclusive listing agreement was from April 30, 1977 to October 30, 1977, and Tucker Realty was to receive a 6% commission if it found a ready, willing, and able purchaser for the farm.²

On June 21, 1977, Tucker Realty presented to Saemann a written offer from a group of individuals interested in purchasing the west acreage of City Edge Farm, a total of 120 acres, for \$2500 an acre, conditioned upon the grant of a five year option to purchase the remaining 82.5 acres for \$2500 an acre. Saemann accepted the offer. The acceptance contained a provision for a broker's commission which read: "[seller agrees] to pay to Tucker Realty licensed broker, the sum of eighteen thousand Dollars (\$18,000.00) commission for his services rendered in this transaction."³

In February 1982, purchasers exercised their option to purchase the remaining portion of the farm for \$206,250 and Tucker Realty demanded a six percent commission (\$12,375.00) on the sale. Saemann denied owing a commission and Tucker Realty filed suit.⁴

The trial court granted Tucker Realty's motion for summary judgment. In so doing, the trial court, based upon a review of decisions from other jurisdictions contained in an American Law Reports annotation, concluded that, in general, even though the broker is not

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1. 529 N.E.2d 126 (Ind. Ct. App. 1988).
2. *Id.* at 127.
3. *Id.*
4. *Id.* at 127-28.

entitled to a commission for procuring an option to purchase, once the option is exercised and the sale completed, the broker's right to a commission accrues.⁵ The trial court further determined that the language in the written acceptance, which provided for the payment of an eighteen thousand dollar commission to Tucker Realty for services rendered in connection with "this transaction" related solely to the immediate purchase of the land and not to the five year option. Thus, the trial court found that the purchase agreement was silent as to the rights of the broker to a commission upon the exercise of the option to purchase and that the general rule stated above should apply.⁶ Saemann appealed.⁷

The court of appeals first observed that, under Indiana caselaw, in order to recover a commission under a written listing agreement, the broker must prove:

- (1) That an actual sale or transfer of the realty occurred;
- (2) That the broker procured a purchaser, who was ready, willing and able to purchase the realty on terms specified in the contract and the seller refuses to complete the transaction; or
- (3) That a third party entered into a valid executory contract with the vendor for the purchase of the realty through the broker's procurement of such third party.⁸

The court agreed with Saemann's contention that Tucker Realty met none of these requirements within the terms of the listing agreement. The broker's right to a commission is to be determined from the terms of the contract of employment. In this case, the broker was employed to locate a ready, willing and able buyer during the six month term of the listing agreement. Obtaining a five year option to purchase was outside the terms of the listing agreement.⁹

The court rejected Tucker Realty's argument that, by accepting the option to purchase agreement, Seaman ratified their performance and waived the original terms of the listing agreement. Indiana law, however, requires that a listing agreement be in writing before a broker may

5. *Id.* at 128. The trial court relied heavily upon the general rule set forth in Annotation, *Broker's Right to Commission from Principal upon Procuring Third Party Taking an Option*, 32 A.L.R. 3d 321 (1970).

6. *Id.*

7. The personal representative of Saemann's estate was substituted as a party, following the death of F.I. Seaman. *Id.*

8. *Id.* at 129, citing *Wilson v. Upchurch*, 425 N.E.2d 236, 238 (Ind. Ct. App. 1981).

9. 529 N.E.2d at 129.

recover any commission on the sale of land.¹⁰ As the court noted, this statute was enacted "for the specific purpose of preventing disputes over terms of the commission contracts."¹¹ Furthermore, written agreements are required to define the essential terms of the relationship between the broker and the seller, which have been found to include: "[A]n extension of time for performance; . . . a description of the performance required of the broker; . . . the length of time to be allowed the broker to perform; . . . and the amount of commission or fee to be paid to the broker for his performance."¹² The court then concluded "that commissions to be paid upon either the grant or execution of an option to purchase is another such essential element where a broker has failed to provide for an extension of time for performance."¹³ While the exercise of the option to purchase did result in a sale, there was no extension of time for performance and the option was exercised more than four years after the time period in the listing agreement had expired. Thus, the time limitation in the agreement controls regardless of the construction given to the words "this transaction" in the acceptance of the offer to purchase.¹⁴ The failure to provide a contractual provision specifically describing the rights of the parties in the event of a grant of an option to purchase or for a written extension of time was fatal to Tucker Realty's case.¹⁵ As the court remarked, its holding "will lead to more definitive listing agreements which accurately and completely describe the intentions of the parties."¹⁶

II. JOINT TENANCY: MULTIPLE-PARTY BANK ACCOUNTS

Indiana's multiple-party accounts statute¹⁷ provides that sums remaining on deposit at the death of a party to a joint accounts¹⁸ belong

10. "No contract for the payment of any sum of money or thing of value, as and for a commission or reward for the finding or procuring by one (1) person of a purchaser for the real estate of another, shall be valid unless the same shall be in writing, signed by the owner of such real estate or his legally appointed and duly qualified representative. . . ." IND. CODE § 32-2-2-1 (1988).

11. *Saemann*, 529 N.E.2d at 130 (citing *Gerardot v. Emenhiser*, 173 Ind. App. 353, 363 N.E.2d 1072 (1977)).

12. *Id.* (citations omitted).

13. *Id.*

14. *Id.* at 129-30.

15. *Id.*

16. *Id.* at 130-31.

17. IND. CODE §§ 32-4-1.5-1 to -15 (1988).

18. The statute defines a joint account as "an account payable on request to one or more of two (2) or more parties whether or not mention is made of any right of survivorship. . . ." *Id.* § 32-4-1.5-1(4). A "party" is defined as "a person who, by the terms of the account, has a present right, subject to request, to payment from a multiple-party account. . . ." *Id.* § 32-4-1.5-1(7).

to the surviving party or parties as against the estate of the deceased party.¹⁹ Normally, a joint account is opened in the names of all the parties to the account. In *Rubsam v. Estate of Pressler*,²⁰ an account was opened in the name of only one person, but that person and another both signed the signature card without indicating whether or not a right of survivorship was intended. Upon the death of the party in whose name the account was opened, the question became whether the surviving signatory to the account was entitled to the funds on deposit.

In *Rubsam*, Maedean Rubsam, the surviving signatory on the bank account, and Viva Pressler, in whose name the account was opened, had been close friends for many years.²¹ In February 1983, Rubsam and the deceased went to the Hancock Bank & Trust. Rubsam went into the bank alone and instructed the officer responsible for opening and closing accounts to close the decedent's saving account and to open a new checking account.²² Rubsam took the signature card to the car where it was signed by the deceased. The new account was opened in the name of the deceased only, but both the deceased and Rubsam were named as signatories to the account, and both were permitted to make deposits and unlimited withdrawals from the account. Decedent made all deposits to the account over the next five years. There were two boxes on the signature card, one indicating a joint account with right of survivorship, and the other indicating no right of survivorship was intended. Neither box was marked.²³

At Pressler's death, the bank informed Rubsam that the funds in the checking account would be turned over to the executor of Pressler's estate.²⁴ Rubsam filed a claim against the estate for the funds in the account. The executor disallowed the claim, and Rubsam brought this action. The trial court found for the estate and Rubsam appealed.²⁵

On appeal, the court began by observing that Indiana's multiple-party accounts statute defines an account as "joint" whether or not a right of survivorship is expressed,²⁶ and that a "party" is defined as

19. *Id.* § 32-4-1.5-4.

20. 537 N.E.2d 520 (Ind. Ct. App. 1989).

21. *Id.* at 521. In addition to the account in question, Pressler had purchased four certificates of deposit with right of survivorship with Rubsam and had opened a saving account with Rubsam jointly with right of survivorship. Rubsam was also the income beneficiary of a trust funded by the residuary of Pressler's estate. *Id.*

22. *Id.* The court observed that even if Rubsam had no authority to open the account, the decedent by making deposits into the account for five years had ratified the act of opening the account. *Id.* at 522 n.1

23. *Id.* at 521-22.

24. *Id.* at 522. Four certificates of deposit and a bank account owned jointly by Pressler with Rubsam were immediately transferred to Rubsam by the bank. *Id.*

25. *Id.*

26. IND. CODE § 32-4-1.5-1(4) (1988).

one with a present right to request payment from the multiple-party account.²⁷ Upon the death of a party, the statute provides that sums remaining on deposit in a multiple-party account belong to the surviving party or parties as against the estate of the decedent. . . ."²⁸

Rubsam claimed that she was a "party" to the account and entitled to the funds remaining on deposit at Pressler's death. The estate, on the other hand, argued that Rubsam was merely an "agent" of the deceased.²⁹ In finding that Rubsam was a party to the account, the court noted the lack of any evidence suggesting that Rubsam was an agent, other than for the limited purpose of closing the savings account and opening the checking account. No one at the bank spoke to the deceased at the time the account was opened and nothing on the signature card suggested that Rubsam was an agent.³⁰

Next the estate attempted to rebut the presumption that the account was intended to be a survivorship account by pointing out that the account was opened in the name of the decedent only and not jointly with Rubsam. The court concluded, however, that the name on the account had no legal significance: "Rubsam could have named the account 'Mickey Mouse'; such a name would not make Disney's character the owner of the account." The "ownership" of the account is evidenced by the 'present right to withdraw' the funds or other contractual agreements.³¹ In the present case, the court found that Rubsam had proved she had a present right to withdraw funds from the account and therefore was entitled to the sums remaining in the account at the decedent's death.³²

The estate also argued that, in order to file a claim against the estate, Rubsam must be the owner of a debt or demand of a pecuniary nature which could have been enforced against the decedent during her lifetime and which could have been reduced to a simple money judgment.³³ In rejecting this contention, the court observed that, as a signatory to the account agreement, Rubsam had obligated herself jointly and severally with the decedent to pay any amounts chargeable to the account for which there were not sufficient funds in the account, and

27. *Id.* § 32-4-1.5-1(7) (One who is merely authorized to make a request for payment as agent of the other is not a "party" to the account).

28. *Id.* § 32-4-1.5-4.

29. 537 N.E.2d at 522. The statute expressly excludes from the definition of a party "a person who is merely authorized to make a request (for payment from a multiple-party account) as the agent of another." IND. CODE § 32-4-1.5-1(7) (1988).

30. 537 N.E.2d 522-24.

31. *Id.* at 524.

32. *Id.* at 523.

33. *Id.* at 524.

that this was sufficient consideration to make her a party to the account agreement with the bank and with the decedent. Rubsam and the decedent each impliedly obligated themselves, on behalf of their estate, to pay any sums left in the account at their death, should they be the first to die, to the survivor and not to make any claim to such funds. Even though this latter obligation of the deceased could not be breached until after her death, it was an outgrowth of a contractual obligation entered into by the deceased during her lifetime. While Rubsam had no demand of a pecuniary nature prior to the decedent's death, the court concluded that it was a claim properly made against the estate, particularly since the breach could only occur after death.³⁴

Finally, the estate argued that Rubsam was suing the wrong party since the funds were still being held by the bank, or, alternatively, that the bank was an indispensable party.³⁵ The court rejected both theories. While it was true that the bank was still in possession of the funds, the court noted that a bank official had indicated he would turn the funds over to the executor upon his request, and the executor had included the funds in the inventory of estate assets. While Rubsam could have brought the action against the bank for breach of contract or joined the bank as a party, the bank was not an indispensable party, and Rubsam could elect to sue the decedent's estate for breach of the bank account agreement. The court noted that the multiple liability portion of Indiana Trial Rule 19(A)(2)(b) only applies to those already parties and not to those sought to be joined.³⁶ In a concurring opinion, Judge Staton expressed concern that the bank might be subject to multiple liability as trustee of the trust established in the residuary clause of Pressler's will.³⁷ The case was reversed and remanded with instructions to enter judgment in favor of Rubsam.³⁸

III. LANDLORD AND TENANT

A. *Breach of Rental Agreement by Tenant: Landlord's Remedies*

In *Nylen v. Park Doral Apartments*,³⁹ three Indiana University students entered into a lease at Park Doral Apartments in Bloomington, Indiana, for a term beginning August 26, 1986, and ending August 19, 1987. At the end of the fall semester, one of the students moved out

34. *Id.* at 524-25.

35. *Id.* at 525.

36. *Id.*

37. *Id.* at 526 (Staton, J., concurring).

38. *Id.* at 525.

39. 535 N.E.2d 178 (Ind. Ct. App. 1989).

and refused to pay any further rent. When the remaining two students paid only two-thirds of the rent for the month of February 1987, Park Doral brought an action for ejectment and for damages. While the ejectment action was pending, the students paid an additional \$280 for the rent due in March. The trial court ordered the two students to pay the full rent or vacate the premises. The students vacated the apartment on March 13, 1987. A final hearing was held in September, 1987, and the trial court awarded Park Doral the balance of the rent due under the lease, \$140 per month for February and March and \$420 per month for April through July. A \$420 security deposit was used to pay the last month's rent. The court also awarded late fees, attorney fees and consequential damages for a total of \$2,577.24 plus costs.⁴⁰

On appeal, the appellants argued that the award of future rents was contrary to law because the eviction terminated the lease and all obligations under it, including the obligation to pay rent. A second, closely related argument, was that the court had permitted the landlord to pursue inconsistent remedies of eviction and recovery of post-ejectment rents. In answering these arguments, the court observed that the rental agreement contained a "saving clause" which provided: "Eviction of tenant for a breach of lease agreement shall not release tenant from liability for rent payment for the balance of the term of the lease."⁴¹ Where the lease contains such a clause the court concluded that eviction does not affect liability for future rents.⁴² The court examined a number of earlier Indiana cases and concluded that "[c]ontrary to appellants' contention there is case law in Indiana recognizing and enforcing saving clauses."⁴³ Thus, the saving clause obligated the tenants to pay the rent to the end of the term notwithstanding an order of eviction. With regard to the second issue, the court found that the remedy of eviction for non-payment of rent was not inconsistent with an action for future rents under the saving clause.⁴⁴

Appellants next claimed that the judgment of the trial court was inconsistent with the landlord's duty under Indiana law to mitigate

40. *Id.* at 180.

41. *Id.* at 181.

42. *Id.* The court noted that without a saving or indemnity clause the exercise of a power of termination ends the landlord-tenant relationship and the duty to pay rent. *Id.* See also R. SCHOSHINSKI, AMERICAN LAW OF LANDLORD AND TENANT § 6.1 (1980) [hereinafter SCHOSHINSKI].

43. *Nylen*, 535 N.E.2d at 181.

44. *Id.* at 182-83. The court concluded that where the lease provides that the landlord may re-enter for the non-payment of rent or other breach, the suit for ejectment is merely a means of enforcing the lease and "did not preclude recovery of future rents under the saving clause." *Id.* at 183.

damages.⁴⁵ By the eviction, the landlord lost the two-thirds of the rent being paid by the remaining two students and, since he was unable to relet the apartment for the remainder of the term, the damages were exacerbated. The court, however, rejected this argument because, if accepted, it would mean the landlord would be forced to tolerate a breach in order to mitigate its damages.⁴⁶ The court found that the landlord attempted to relet the apartment by placing an advertisement in the Indiana Daily Student newspaper and subsequently even reduced the rent in an effort to find a tenant.⁴⁷ In a related argument, appellants claimed that enforcement of the saving clause worked a forfeiture which is not permitted under *Skendzel v. Marshall*.⁴⁸ In *Skendzel*, the Indiana Supreme Court prohibited a forfeiture of a purchaser's equity under a land contract.⁴⁹ The court in *Nylen*, however, refused to extend *Skendzel* to cases not involving a purchase equity.⁵⁰

The appellants also challenged the trial court's award of late fees. The lease contained a provision authorizing the landlord to charge a late fee of \$2 per day per person if the rent was not paid on the first day of each month. The court found that the fee was liquidated damages and not a penalty. The management testified that failure to pay rent on time resulted in extra work and loss of interest income. Since the duty to pay rent continued to the end of the term the late payments could be extended beyond the time of ejectment.⁵¹

Finally, the appellants argued that the rental agreement was unconscionable. While admitting that there may have been a disparity in bargaining power between the parties, the court found that the disparity had not led the appellants to sign the lease unwillingly or unaware of its terms. For, as the court stated, "[c]ontracts are not unenforceable simply because one party enjoys an advantage over the other."⁵² The

45. *Id.* Indiana requires the landlord to mitigate damages where the tenant has breached the lease. See *State v. Boyle*, 168 Ind. App. 643, 344 N.E.2d 302 (1976); *Hirsch v. Merchants Nat'l Bank*, 166 Ind. App. 497, 336 N.E.2d 833 (1975).

46. *Nylen*, 535 N.E.2d at 183.

47. *Id.* While it is clear that the landlord made an effort to relet the apartment once it had evicted the two students, was it reasonable to evict students in the middle of a school term in a university town and expect to be able to relet the apartment? If the landlord would be required to relet the apartment for two-thirds the amount of rent stated in the rental agreement in order to mitigate damages, why should it be permitted to evict the tenants already paying this amount and allow the apartment to remain vacant for the remainder of the term?

48. 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974).

49. *Id.*

50. *Nylen*, 535 N.E.2d at 183.

51. *Id.* at 184.

52. *Id.* at 185 (quoting *Hovin v. Bremen*, 495 N.E.2d 753, 758 (Ind. Ct. App. 1986)).

students had neither objected to the lease or sought modification.⁵³ The appellants had relied heavily upon *Weaver v. American Oil Co.*,⁵⁴ but as the court noted, *Weaver* indicates that to be unconscionable, the contract must be one "such as no sensible man not under delusion, duress or in distress would make, and such as no honest and fair man would accept."⁵⁵

On appeal, Park Doral claimed that it was entitled to appellate attorney fees based upon Paragraph 3 of the Rental Agreement:

If the tenant(s) defaults in the performance of any of the covenants of this lease agreement and by reason thereof the Landlord employs the services of an attorney to enforce performance of the covenants by the tenant . . . then, in any of said events the tenant does agree to pay a reasonable attorney's fee and all expenses and costs incurred by the landlord pertaining thereto. . . .⁵⁶

The court acknowledged that in the past, landlords had been denied appellate attorney fees under the theory that the award of attorney fees at the trial level was deemed to have been merged into the judgment and the contractual authorization no longer existed. Recently, however, Indiana courts have excepted appellate attorney fees from the general rule of merger. Thus, the doctrine no longer precludes the award of appellate attorney fees.⁵⁷ The court did not appear concerned over the "chilling effect" the award of appellate attorney fees would have on future appeals by individual tenants: "This court is not persuaded that disparity in bargaining power necessitates a departure from precedent allowing the recovery of reasonable attorney fees incurred in defending an appeal."⁵⁸ The judgment of the trial courts was affirmed but the case was remanded for a hearing on reasonable appellate attorney fees.⁵⁹

53. *Id.* at 184-85. When one examines the case closely, it becomes obvious that well over half the amount recovered by the landlord came from "standard" provisions in the rental agreement. The tenants agreed to remain liable for the rent for the remainder of the term even if evicted, the tenants agreed to pay a \$2 per day per person late fee until any rent due and owing was paid, and they agreed to pay the landlord's attorney fees if the landlord should be forced to bring suit to enforce the rental agreement (including appellate attorney fees should they appeal a lower court decision in favor of the landlord). The court points out that the tenants did not "sign the lease unwillingly and unaware of its terms." *Id.* at 184. But did these young students really believe that in a university town with a limited supply of decent housing the lease was negotiable?

54. 257 Ind. 458, 276 N.E.2d 144 (1971).

55. 257 Ind. at 462, 276 N.E.2d at 146.

56. 535 N.E.2d at 185.

57. *Id.*

58. *Id.*

59. *Id.*

B. Covenant Against Assignment: Landlord's Right of Refusal in Commercial Leases

A leasehold interest is freely transferable by the tenant unless there is a covenant in the lease prohibiting an assignment or sublease either absolutely or without the consent of the landlord.⁶⁰ However, covenants prohibiting the tenant from transferring his leasehold estate without the consent of the landlord are standard "boilerplate" in many leases.⁶¹ Where a covenant in the lease requires the consent of the landlord to an assignment or sublease by the tenant, the courts have traditionally held the landlord can withhold his consent arbitrarily or capriciously, unless there is language in the covenant providing that such consent shall not be unreasonably withheld.⁶² Recently, however, courts have begun to move away from the arbitrary and capricious right of refusal rule, and have held that the withholding of consent by the landlord should be governed by the principles of good faith and commercial reasonableness.⁶³

In *First Federal Savings Bank v. Key Markets, Inc.*,⁶⁴ a trust purchased a one acre tract in Sheffield Commons Shopping Center from the developer, Joseph McLaughlin, to construct a supermarket to be operated by Burger's Supermarkets, Inc.. McLaughlin retained title to the adjoining real estate, but agreed to lease additional space to Burger's for access and parking. A parking lot lease and a common area easement agreement were subsequently entered into by Burger's and McLaughlin.⁶⁵ The parking lot lease contained a "consent clause," requiring the tenant to obtain the consent of the landlord to an assignment of the lease,⁶⁶ and a "cancellation clause," permitting the landlord to cancel the lease under certain conditions.⁶⁷ Burger's constructed the supermarket and parking lot and McLaughlin constructed the remainder of the shopping center. In January 1985, following a series of assignments, consented to by McLaughlin, Key Markets, Inc. succeeded to Burger's interest in

60. SCHOSHINSKI, *supra* note 42, § 8:10 (1980); J. CRIBBET, PRINCIPLES OF THE LAW OF PROPERTY 219 (2d ed. 1975) [hereinafter CRIBBET].

61. R. CUNNINGHAM, W. STOEBUCK & D. WHITMAN, THE LAW OF PROPERTY 386 (1984) [hereinafter CUNNINGHAM].

62. *Id.* at 387-88; CRIBBET, *supra* note 54, at 223.

63. See Annotation, *Withholding Consent—Assignment of Leases*, 21 A.L.R. 4th 188 (1983).

64. 532 N.E.2d 18 (Ind. Ct. App. 1988).

65. *Id.* at 19.

66. Section 10.01(a) of the parking lot lease provides: "Except for an assignment to a "Corporate Affiliate" of Tenant, Tenant shall not assign this lease or sublet all or a portion of the Demised Premises without the consent of Landlord." *Id.* at 20.

67. See *infra* notes 77-81 and accompanying text for a discussion of the cancellation clause.

the supermarket lease, the parking lot lease, and the common area easement agreement. In October 1985, First Federal Saving Bank of Indiana succeeded to McLaughlin's interest through a mortgage foreclosure.⁶⁸

In the fall of 1987, Key Markets entered into negotiations with Babincsak Enterprises, Inc. for the purchase of its supermarket business in Sheffield Commons. Key Markets sent a letter to First Federal requesting its consent to the assignment of its parking lot lease and common area easement agreement to Certified Grocer's, Inc., who would then sublet to Babincsak. Negotiations between Key Markets and First Federal failed to reach agreement regarding the assignment and on December 11, 1987, First Federal notified Key Markets that it was cancelling the parking lot lease by reason of the proposed assignment.⁶⁹

Because of First Federal's refusal to consent to the assignment of the parking lot lease, the closing of the sale to Babincsak was never completed. On December 12, 1987, Key Markets filed a complaint against First Federal seeking declaratory and injunctive relief and damages for cancellation of the lease. After a hearing on the refusal to consent to the assignment and the cancellation issues, the trial court concluded that First Federal had a legal duty not to unreasonably withhold consent to the assignment and that it had no right to cancel the lease. The court permanently enjoined First Federal from enforcement of its cancellation of the lease on the sole motivation of a requested assignment in connection with the sale of the supermarket business.⁷⁰

On appeal, First Federal argued that, absent limiting language providing that such consent shall not be unreasonably withheld, it could refuse consent for any reason.⁷¹ As authority for its position, First Federal initially claimed that *F.W. Woolworth Co. v. Plaza North, Inc.*,⁷² which appears to hold that the landlord can arbitrarily and capriciously withhold consent to an assignment, was dispositive of the issue. In *Woolworth*, however, the lease contained specific language requiring reasonable consent to a subletting while in the same paragraph failing to include similar language in the portion prohibiting assignments. This, the *First Federal Savings* court concluded, showed an express agreement by the parties to allow unreasonable withholding of consent to an assignment.⁷³ Both the trial court and Key Markets relied heavily

68. 432 N.E.2d at 19-20.

69. *Id.* at 20.

70. *Id.*

71. *Id.*

72. 493 N.E.2d 1304 (Ind. Ct. App.), *trans. denied* (1986).

73. *First Federal Savings*, 532 N.E.2d at 21.

on *Sandor Development Co. v. Reitmeyer*.⁷⁴ In *Sandor*, the court held that the landlord had a duty to mitigate damages when the tenant abandons the premises and rejected the position that the landlord's right to refuse assignments under a "use" clause was unconditional. The court, however, also rejected *Sandor* as determinative of the issue since no mitigation question was present.⁷⁵ Instead, the court observed that there is a continuing erosion of the arbitrary and capricious right of refusal rule based on the recognition that a lease is a contract, and, as such, should be governed by the general principles of good faith and commercial reasonableness. The court cited decisions from other jurisdictions adopting a "commercial reasonableness" test, and concluded that the requirement of reasonableness on the part of the lessor is "no more than a means of ensuring good faith, and is in keeping with the overall preference in Indiana for free alienation of land."⁷⁶

The court's adoption of a commercial reasonableness test would have been a hollow victory for Key Markets had the court accepted First Federal's interpretation of the cancellation clause. First Federal argued that Article X, Section 10.01(b) of the parking lot lease gave it the right to cancel the lease upon the attempted assignment. This subsection provides:

Except for an assignment to a "Corporate Affiliate" of Tenant or an assignment *in connection with the sale of the business of Tenant*, Landlord shall have the option to cancel this Lease by giving notice thereof to Tenant within thirty days after Tenant notifies Landlord of the proposed assignment. If Landlord cancels this Lease in accordance with this Section, both parties shall be relieved of liability under this Lease.⁷⁷

It might appear at first that there is no problem since the proposed assignment is in connection with Key Markets' sale of its business. However, subsection 10.01(c), which contains a glossary of terms relevant to Section 10.01, defines the term "sale of the entire business of Tenant," as "the sale of all of the stock of the Tenant and all of the stock of more than 75% of Tenant's Corporate Affiliates to a single person . . .".⁷⁸ Key Markets' assignment does not fall within the definition of this term. First Federal argued that although the word "entire" was omitted from subsection (b), this was the only subsection to which the term could apply. Therefore, a patent ambiguity existed, and the court

74. 498 N.E.2d 1020 (Ind. Ct. App.), *trans. denied* (1986).

75. 532 N.E.2d at 22.

76. *Id.* at 22-23.

77. *Id.* at 23 (emphasis added).

78. *Id.*

should insert the word "entire" in the cancellation clause.⁷⁹ The court rejected this position for several reasons. First, it found that the supermarket lease, the common area easement agreement, and the parking lot lease were all part of an interrelated whole. First Federal's interpretation would render the documents internally inconsistent, since it would allow the Landlord to render the supermarket lease commercially worthless in all but two situations should an assignment be attempted. Likewise, it would render the assignment clause meaningless. Burger's owner testified that "he would not have proceeded to build the supermarket unless parking was assured."⁸⁰ Finally, the court noted that the thirty page parking lot lease contained many unused subsections and appeared to be based on a form. Thus, there was a serious question as to whether the word "entire" was unintentionally left out of subsection (b) or whether the term was mistakenly retained as a definition of a stricken subsection. Based upon extrinsic evidence, the court concluded that the cancellation clause did not apply to a request for an assignment. It could, however, be used should the lessee assign after a reasonable refusal of consent by the landlord.⁸¹

This case is important because it is the first Indiana decision to reject the common law rule that the landlord can arbitrarily and capriciously refuse to allow an assignment of commercial leases unless the covenant against assignments contains the phrase "which consent will not be unreasonably withheld." However, it should be noted that the court limits its holding to assignments of "commercial leases." Whether reasonable grounds for the refusal to consent to an assignment will be required in residential leases remains unanswered.

C. *Landlord's Liability for Criminal Acts of Third Parties*

In *Center Management Corp. v. Bowman*,⁸² Kim Bowman, a tenant in an apartment owned by Center City Housing, sued to recover for the loss of four items of jewelry stolen from her apartment. On February 20, 1986, Bowman discovered the loss of a \$50 bill from her apartment and reported the loss to Center Management Corporation, the managing company of the apartment building, and to the South Bend police. On February 27, 1986, Bowman discovered the loss of four items of jewelry from the apartment. A subsequent police investigation concluded that entry to the apartment had been gained by the use of a key. Following

79. *Id.* at 23-24.

80. *Id.* at 25.

81. *Id.*

82. 526 N.E.2d 228 (Ind. Ct. App. 1988).

a trial, the court held Center City and Center Management jointly and severally liable for the loss.⁸³

On appeal, the court noted that, while the parties and the amicus did not refer the court to any Indiana decisions "Many courts have abrogated or softened the common-law rule that a landlord is not under a duty to protect a tenant from loss or injury due to criminal conduct by a third party."⁸⁴ After examining decisions from other jurisdictions holding that the landlord is under a duty to protect the tenant from the reasonably foreseeable criminal acts of third persons, the court adopted the three considerations expressed in *Morgan v. Dalton Management Co.* as a practical method of determining when such a duty would exist.⁸⁵ Under *Morgan*, whether such a duty exists depends upon: (1) the foreseeability of the injury; (2) the magnitude of the burden of guarding against the injury; and (3) the consequences of placing that burden upon the landlord.⁸⁶

In the present case, the court found that the second burglary was reasonably foreseeable. The landlord was made aware of the first burglary and the probable method of entry. The court also rejected the defendants argument that the magnitude of the burden of guarding against another such occurrence was prohibitive. The defendants had, by allowing twelve of their employees and an unknown number of employees of a carpet cleaning company access to master keys, "effectively thwarted any attempt to determine who perpetrated the first burglary and to reduce the risk of further burglaries."⁸⁷ The court found that the evidence supported the conclusion that the breach of the duty to protect the tenant against loss or injury due to the criminal conduct of third parties was the proximate cause of the injury to the tenant. The tenant had always locked her door and had not given her key to anyone, similar burglaries had occurred in the apartment complex, part of the missing jewelry was discovered in a pawn shop frequented by one of the defendant's employees, and there were no signs of forced entry. The judgment was affirmed.⁸⁸

D. *Landlord's Liability for Personal Injuries Caused by Defective Condition of Leased Premises*

Traditionally, the landlord has not been held liable for personal injuries resulting from defective conditions on the leased premises.⁸⁹

83. *Id.* at 229.

84. *Id.* at 229-30.

85. 117 Ill. App. 3d 815, ____ , 454 N.E.2d 57, 60 (1983).

86. 526 N.E.2d at 230.

87. *Id.*

88. *Id.* at 230-31.

89. SCHOSHINSKI, *supra* note 42, § 4:1 at 186-87; Browder, *The Taming of a*

This tort immunity is based in part upon the theory that once the landlord has given up possession and control of the premises to the tenant, he is without authority to reenter to make repairs and should not be held responsible for defective conditions which he has no power to correct.⁹⁰ While the tort immunity of the landlord was the general rule, there soon developed a series of exceptions.⁹¹ Indiana decisions have held the landlord liable for personal injuries caused by: (1) latent defects known to the landlord but unknown to the tenant, which the landlord fails to disclose to the tenant;⁹² (2) defects in premises leased for admission of the public;⁹³ (3) breach of a covenant to repair;⁹⁴ (4) negligent repairs;⁹⁵ (5) defects in areas used in common by the tenants, and over which the landlord retains control⁹⁶; and (6) an unexcused or unjustified violation of a duty prescribed by an applicable statute or ordinance.⁹⁷

Recently, with the recognition of an implied warranty of habitability in residential leases, the general tort immunity of the landlord for injuries arising out of defective conditions of the leased premises has been seriously questioned.⁹⁸ If the landlord can be held liable for failure

Duty—The Tort Liability of Landlords, 81 MICH. L. REV. 99, 101-02 (1982) [hereafter *Browder*].

90. Great Atl. & Pac. Tea Co. v. Wilson, 408 N.E.2d 144 (Ind. Ct. App. 1980); Zimmerman v. Moore, 441 N.E.2d 690, 694 (Ind. Ct. App. 1982).

91. For a detailed discussion of these exceptions to the landlord's common law tort immunity, see Love, *Landlord's Liability for Defective Premises: Caveat Lessee, Negligence, or Strict Liability?*, 1075 WISC. L. REV. 19, 50-78 (1975); and SCHOSHINSKI, *supra* note 42, §§ 4:2 - 4:9.

92. See, e.g., Eggers v. Wright, 143 Ind. App. 275, 240 N.E.2d 79 (1968); Guenther v. Jackson, 79 Ind. App. 127, 137 N.E. 528 (1922).

93. Chrysler Corp. v. M. Present Co., 491 F.2d 320 (7th Cir. 1974) (where property leased for a "public purpose" lessor is under duty to use reasonable care to inspect and repair premises before transferring possession); Walker v. Ellis, 126 Ind. App. 353, 129 N.E.2d 65 (1955) (landlord liable where he leases premises for a public purpose which he knows are unfit and dangerous).

94. Hunter v. Cook, 149 Ind. App. 657, 274 N.E. 550 (1971); Robertson Music House v. Wm. H. Armstrong Co., 90 Ind. App. 413, 63 N.E. 839 (1928).

95. See, e.g., Hunter v. Cook, 149 Ind. App. 657, 274 N.E.2d 550 (1971); Robertson Music House v. Wm. H. Armstrong Co., 90 Ind. App. 413, 63 N.E. 839 (1928).

96. See, e.g., Flott v. Cates, 528 N.E.2d 847 (Ind. Ct. App. 1988); Slusher v. State, 437 N.E.2d 97, *transfer denied* (Ind. Ct. App. 1982); Coleman v. DeMoss, 144 Ind. App. 408, 246 N.E.2d 483 (1969). One could argue that the landlord's liability for injuries caused by defective conditions in common areas is really not an exception to the rule since the landlord still retains possession and control over these areas.

97. Zimmerman v. Moore, 441 N.E.2d 690, 696 (Ind. Ct. App. 1982); Rimco Realty & Investment Corp. v. La Vigne, 114 Ind. App. 211, 50 N.E.2d 953 (1943).

98. *Browder*, *supra* note 89, at 116-41; SCHOSHINSKI, *supra* note 38, § 4:9 at 203-

to repair when there is an express covenant to repair, then why should the landlord not be held liable where a *duty* to repair is created in a residential lease by an implied warranty of habitability?⁹⁹ Several interesting cases decided during this survey period touch upon the liability of the landlord for injuries resulting from the condition of the leased premises.

1. *Covenant to Repair.*—In *Childress v. Bowser*,¹⁰⁰ Richard and Donna Childress and their four children rented a house from Carl Bowser on an oral month-to-month lease. At the inception of the lease, Bowser instructed Richard that he was not to do anything to the house. In May or June 1985, Richard requested that Bowser repair leaking faucets and the rear door of the house. Although Bowser promised that he would take care of the problems, the back door was not fixed and Donna suffered injuries to her arm as she was leaving the house through the rear door. Donna sued Bowser for her injuries and the trial court granted a summary judgment in favor of the landlord.¹⁰¹

In reversing the judgment, the court of appeals noted that normally the landlord is not liable for personal injuries to the tenant caused by defective conditions on the premises, but that there is an exception to this rule where the landlord “expressly agrees to repair and is negligent in doing so.”¹⁰² The court concluded that the landlord’s remark “Don’t

06, For a collection of recent decisions addressing the landlord’s liability for personal injuries resulting from breach of an implied warranty of habitability *see* SCHOSHINSKI, *supra* note 42, at § 4:9 (1989 Supp.).

99. Despite the apparent logic of this argument a number of jurisdictions have refused to change the traditional tort immunity of the landlord because of the recognition of an implied warranty of habitability in residential leases. A few states have imposed strict tort liability on the landlord for breach of the implied warranty of habitability by analogy to the RESTATEMENT (SECOND) OF TORTS § 402A (1965), and others have imposed tort liability on the landlord under a negligence theory for failure to repair. *See generally Browder, supra* note 89, at 116-41.

100. 526 N.E.2d 1209 (Ind. Ct. App. 1988). After the survey period, the Indiana Supreme Court granted transfer and affirmed the decision of the court of appeals. *Childress v. Bowser*, 546 N.E.2d 1221 (Ind. 1989). In an opinion by Chief Justice Shepard, the court held that a binding covenant to repair could reasonably be inferred from the landlord’s admonition to the tenant to do nothing to the leased premises and by his later promises to make a specific repair.

101. *Id.* at 1210.

102. *Id.* at 1210. The wording used by the court is identical to that used in *Zimmerman v. Moore*, 441 N.E.2d 690 (Ind. App. 1982), cited in the opinion. However, another case cited by the court in support of the exception to the rule, *Hunter v Cook*, 149 Ind. App. 657, 274 N.E.2d 550 (1971), states the exception differently: “a tenant cannot recover for personal injuries . . . caused by defective condition of the leased premises unless the landlord either agrees to repair, *or* in doing so is negligent.” (emphasis added). This language suggests the landlord not only will be liable where he covenants to repair *and* does so in a negligent manner, but also where he (1) agrees to repair and

change nothing, don't nail a lot of nails in, don't do nothing to the house," created a promise on the part of the landlord to make repairs on the premises.¹⁰³ There was also further evidence of a promise to repair when the landlord, upon being told that the back door was inoperative, replied that one of his employees would "take care of it."¹⁰⁴

The court rejected the landlord's argument that because the tenant had taken possession of the premises before the promise to repair was made, there was no consideration to support the covenant to repair. In the case of a month-to-month tenancy, the court concluded that the tenancy recommences at the expiration of each month and thus the decision to continue the tenancy constitutes consideration for the promise to repair.¹⁰⁵ The granting of the landlord's motion for summary judgment was reversed and the case remanded to the trial court.¹⁰⁶

The plaintiff sued on a theory of negligence and the question of an implied warranty of habitability was not raised. Nevertheless, the court's remark that "[i]t is well established in this state that a landlord is not liable for personal injuries to a tenant for defective premises unless he *expressly agrees to repair*,"¹⁰⁷ would appear to reject liability for such injuries under a theory of implied warranty of habitability.

2. *Violation of Statute or Ordinance*.—In *Hodge v. Nor-Cen, Inc.*,¹⁰⁸ tenants, occupant, and guests in front upstairs apartment sued the landlord (Nor-Cen, Inc.) for personal injuries resulting from lack of workable windows and a second means of egress from two-story apartment building. There was only one stairway exit from the front upstairs apartment leading to the ground level. Martha Short rented both the front downstairs apartment (where she had been living with her grandchild, Misty Cornette) and the front upstairs apartment, where she subsequently moved so that her daughter, Teresa Cornette, and Teresa's three children, Daniel Hodge, Tiffany Cornette and Shaya Cornette,

fails to do so, or (2) voluntarily makes repairs and does so in a negligent manner. See *Robertson Music House v. Wm H. Armstrong Co.*, 90 Ind. App. 413, 415-16, 163 N.E. 839 (1928); *Stover v. Fechtman*, 140 Ind. App. 62, 64-65, 222 N.E.2d 281, 283 (1966).

Despite the use of the phrase "and is negligent in so doing," the court of appeals reversed the trial court's granting of the landlord's motion for a summary judgment even though no repairs had been made by the landlord. This indicates that the "negligence in so doing" includes failure to repair as well as making the repairs in a negligent manner.

103. 526 N.E.2d at 1211.

104. *Id.*

105. *Id.* at 1211-12.

106. *Id.* at 1212.

107. *Id.* at 1210 (emphasis added).

108. 527 N.E.2d 1157 (Ind. Ct. App. 1988).

could live in the downstairs apartment. Teresa and her three children were living in the front upstairs apartment with Nor-Cen's consent pending their move into the downstairs apartment. In addition, another occupant, Marilyn Gallion, was apparently subletting a room from Short in the upstairs apartment without Nor-Cen's knowledge. On the night of May 24, 1982, Teresa returned to the apartment with a friend, Marshall King. Short left for work just as Teresa and King arrived. Teresa admits she may have failed to lock the storm door and a sturdy wooden door with an inside deadbolt lock at the ground level entrance to the upstairs apartment. In the early morning hours, an unknown individual entered the building, spread an accelerant in the upstairs hallway, on the stairway, and in the lower foyer and started a fire trapping the persons in the front upstairs apartment.¹⁰⁹

After discovering the fire, the persons in the apartment began searching for a means of escape. They found that some of the windows would not open properly and they were forced to break them to provide a means of escape. Gallion and Teresa jumped out a window they broke in the master bedroom, King broke a living room window and was able to save Tiffany and Daniel. Shaya and Misty died in the fire.¹¹⁰ The plaintiffs (Martha Short, Teresa Cornette, Marshall King and Marilyn Gallion) brought an action against Nor-Cen for personal injuries based on negligence, strict liability and breach of warranty of habitability.¹¹¹ The plaintiffs appealed a summary judgment granted Nor-Cen by the trial court.¹¹²

Two issues were raised on appeal. The first issue was whether the trial court was in error in concluding that Nor-Cen's violation of a city ordinance could not support appellants' negligence claim. The court began its discussion of this issue by observing that ordinarily a landlord is not liable for injuries caused by the defective condition of the leased premises once possession and control of the premises has been surrendered.¹¹³ However, the court noted four exceptions to this general rule: (1) where the landlord covenants to repair or is negligent in making repairs; (2) where the injury is caused by a latent defect known to the landlord and unknown to the tenant which the landlord fails to disclose; (3) where the injuries occur in a common area over which the landlord retains control; and (4) where there is an unexcused or unjustified violation of a duty prescribed by statute or ordinance if the statute is

109. *Id.* at 1158-59.

110. *Id.* at 1159.

111. *Id.* The basis of Short's claim is not clear since the facts indicate she was at work at the time of the fire. *Id.*

112. *Id.*

113. *Id.* at 1159.

intended to protect the class of persons in which plaintiff is included and against the risk of the type of harm which has occurred as result of its violation.¹¹⁴ While there was no indication from the facts that the first three exception applied, the court observed that, in this case, there was a violation of a Marion City Ordinance which provides: "Every dwelling unit shall have a minimum of two safe, unobstructed means of egress leading to safe and open space at ground level."¹¹⁵

The trial court, based upon a reading of other provisions of the ordinance, concluded that the ordinance was promulgated only to assure adequate light and ventilation.¹¹⁶ While conceding that not all of the sections of the ordinance are safety measures, the court of appeals concluded that "Section 4.9 clearly anticipates the increased risk of injury to a dwelling's occupants if they have but one route of egress in case of fire or other disasters necessitating rescue or escape."¹¹⁷ The court also rejected Nor-Cen's argument that the acts of the arsonist, and not the failure to provide a second means of egress, was the proximate cause of the injury:

Here, the landlord's act of failing to provide a second means of egress is an act which generates an unreasonable amount of risk when there is a disaster necessitating escape or rescue. Fire, whether by accident or design, is not an intervening event which breaks the causal connection between the act of failing to provide a second means of egress and the injury occasioned by the inability to escape; it is merely an event in the chain of causation.¹¹⁸

Judge Buchanan, in a dissenting opinion, did not agree with the majority on the causation issue. In his view, the criminal act of arson was not a reasonably foreseeable consequence of Nor-Cen's violation of the ordinance. Nor-Cen had no knowledge of criminal activities in the neighborhood, and had provided locks for the front door, which apparently had been left open by the Tenants allowing access to the building.¹¹⁹

The second issue raised on appeal was whether the trial court had erred in determining that personal injuries were not recoverable under

114. *Id.* at 1160.

115. *Id.* (quoting Marion, Indiana, Ordinance 11-1960 § 4.9).

116. 527 N.E.2d at 1160. In a footnote the court of appeals noted that the violation of an administrative regulation has been held to be only evidence of negligence and could not survive a motion for summary judgment if the element of duty rested solely on the existence of such an administrative regulation. *Id.* at n.3.

117. *Id.* at 1161.

118. *Id.*

119. *Id.* at 1162-63 (Buchanan, J., dissenting).

a breach of an implied warranty of habitability theory. The court observed that while Indiana has recognized an implied warranty of habitability in residential leases, it has not considered whether the warranty provides a basis for relief on claims of personal injury.¹²⁰ The court decided "because appellants fail to present a compelling argument for the extension of the warranty of habitability to personal injury claims, we leave the issue to another time."¹²¹ The judgment on the negligence claim was reversed and remanded for further proceedings.¹²²

E. Legislation: Security Deposits

The 1989, Indiana General Assembly enacted legislation regulating security deposits in residential leases.¹²³ The statute provides that within forty-five days after termination of the rental agreement and delivery of possession, all of the security deposit held by the landlord must be returned to the tenant except for any amount applied to the payment of accrued rent, damages which the landlord has suffered or will suffer as a result of the tenant's noncompliance with the law or the rental agreement, and unpaid utility or sewer charges which the tenant is obligated to pay under the rental agreement.¹²⁴ Any amount applied by the landlord for damages or other obligations of the tenant against the security deposit must be itemized, "including the estimated cost of repair for each damaged item and the amounts and lease on which the landlord intends to assess the tenant."¹²⁵ The itemized list of damages, together with a check or money order for the difference between the damages claimed and the security deposit held by the landlord, shall

120. *Id.* at 1161.

121. *Id.* at 1162.

122. *Id.*

123. Pub. L. No. 277-1989, 1989 Ind. Acts 1954 (codified at IND. CODE ANN. § 32-7-5 (Burns Supp. 1989)). The statute applies to all rental agreements for dwelling units located in Indiana entered into on or after July 1, 1989. 1989 Ind. Acts 1959, Pub. L. No. 277, § 2. The statute defines a security deposit as:

[A] deposit paid by a tenant to the landlord or the landlord's agent to be held for the term of the rental agreement, or any part of the term, and includes:

(1) A required prepayment of rent other than the first full rental payment period of the lease agreement;

(2) A sum required to be paid as rent in any rental period in excess of the average rent for the term; and

(3) Any other amount of money or property returnable to the tenant on condition of return of the rental unit by the tenant in condition as required by the rental agreement.

IND. CODE ANN. § 32-7-5-9(a) (Burns Supp. 1989).

124. *Id.* § 32-7-5-12(a).

125. *Id.* § 32-7-5-14.

be mailed by the landlord to the tenant within forty-five (45) days after termination of occupancy.¹²⁶ Failure to comply with the written notice of damages requirement within forty-five days after termination of occupancy constitutes an agreement by the landlord that no damages are due and the landlord must return the full security deposit to the tenant.¹²⁷ In addition, where the landlord "fails to provide a written statement within forty-five (45) days of termination of the tenancy or the return of the appropriate security deposit" the tenant may recover the part of the security deposit held by the landlord plus reasonable attorney's fees and court costs.¹²⁸

Other provisions of the statute place limits on the purposes for which the security deposit may be used by the landlord,¹²⁹ and prohibit any waiver of the tenant's rights under this statute by contract.¹³⁰ Furthermore, the statute requires the landlord, or any person authorized by the landlord to enter into a rental agreement, to disclose to the tenant in writing, at or before the commencement of the rental agreement, the following names and addresses: "(1) a person residing in Indiana authorized to manage the dwelling unit; (2) a person residing

126. *Id.* However, subsection 12(a)(3) indicates that the landlord is not liable "under this subsection (section 12)" until supplied by the tenant with a mailing address to which the notice and refund may be delivered. *Id.* § 32-7-5-12(a)(3). Since the duty of the landlord to provide an itemized written notice of damages and to return that portion of the security deposit due the tenant is contained in section 12 as well as sections 14-16, it would appear that the requirement that the tenant provide a mailing address to the landlord would apply equally to all the provisions.

127. IND. CODE ANN. § 32-7-5-15 (Burns Supp. 1989).

128. *Id.* § 32-7-5-16. A similar provision is contained in § 32-7-5-12(b) which states that where "the landlord fails to comply with subsection [12](a), the tenant may recover all of the security deposit due the tenant and reasonable attorney's fees." *Id.*

129. *Id.* § 32-7-5-13. The security deposit may be used only for the following purposes:

- (1) To reimburse the landlord for actual damages to the rental unit or ancillary facility not the result of ordinary wear and tear expected in the normal course of habitation of a dwelling.
- (2) To pay the landlord for all rent in arrearage under the rental agreement and rent due for premature termination of the rental agreement, by the tenant.
- (3) To pay for the last payment period of a residential rental agreement where there is a written agreement between the landlord and the tenant that stipulates the security deposit will serve as the last payment of rent due.
- (4) To reimburse the landlord for utility or sewer charges paid by the landlord that:
 - (A) are the obligation of the tenant under the rental agreement; and
 - (B) are unpaid by the tenant.

Id.

130. *Id.* § 32-7-5-17.

in Indiana reasonably accessible to the tenant who is authorized to act as agent for the owner for the purpose of service of process and for the purpose of receiving and receipting for notices and demands.”¹³¹ If the information is not furnished to the tenant at or before the commencement of the rental agreement, the tenant may recover any expenses reasonably incurred in discovering such names and addresses.¹³²

Finally, the statute attempts to define the liability of the original landlord and the new owner for the return of the tenant’s security deposit where the landlord in good faith conveys the property including the dwelling unit to a bona fide purchaser. The statute provides that the landlord shall remain liable to the tenant for the security deposit to which the tenant is entitled for one (1) year after giving written notice to the tenant of the conveyance unless:

- (1) the purchaser acknowledges that the purchaser has assumed the liability of the seller by giving notice to the tenant; and
- (2) upon conveyance the seller transfers the security deposit to the purchaser.¹³³

The literal wording of the statute suggests that the liability of the original landlord for the return of the security deposit terminates at the end of one year following notice to the tenant of the sale. Where the landlord has not transferred the security deposit to the purchaser there does not appear to be any justification for the release of the landlord from his personal covenant to return the security deposit to the tenant. Perhaps the drafters assumed that the new owner would become liable for the return of the security deposit. Subsection 12(d) makes the owner of the dwelling unit at the time of the termination of the rental agreement bound by the provisions of section 12.¹³⁴ However, the language of subsection 12(a) raises a serious question regarding the new owner’s liability for the return of the security deposit. It requires a return of “all of the security deposit *held by the landlord.*”¹³⁵ It does not appear from this wording that the purchaser would be liable for the return of the tenant’s security deposit where the landlord/seller had failed to transfer the security deposit to him.

IV. RECORDING ACT: CHAIN OF TITLE

Each year, the number of documents filed in the public records continues to grow, making the examination of titles to land extremely

131. *Id.* § 32-7-5-18(a). The person authorized to manage the dwelling unit may also be authorized to act as agent.

132. *Id.* § 32-7-5-18(d).

133. *Id.* § 32-7-5-19(a).

134. *Id.* § 32-7-5-12(d).

135. *Id.* § 32-7-5-12(a) (emphasis added).

time consuming and costly. To reduce the burden on the abstractor and the cost to the purchaser, courts have developed a concept referred to as the "chain of title" which permits the search under the name of each grantor in the grantor-grantee index to be limited to the period of time which appears relevant to the title being searched.¹³⁶ This avoids a general search of the records. Occasionally, however, courts have required a more expansive search of the records before the purchaser will be protected by the recording act.

In *Szakaly v. Smith*,¹³⁷ Andrew and Nancy Szakaly Jr. brought suit to determine whether they had an easement over the land of Ron and Linda Smith. The facts indicate that Sherrill and Isabelle Arvin, owned a 195 acre tract of land in Brown County, Indiana. In 1956 the Arvins conveyed 190 acres to the Ransburgs, the Szakalys' predecessors in title. The deed granted an easement of way over the remaining 5 acres still owned by the Arvins, but the deed was not recorded until nine years later in August 1965. The Szakalys derive their title to the dominant estate from two deeds executed and delivered in 1982 and 1983, both recorded in 1983.¹³⁸

In March 1957, the Arvins conveyed the remaining 5 acres to Arressia Allender, trustee, who the same day reconveyed the land to Isabelle Arvin. Neither of these deeds mentioned the easement. Title to the servient estate was deeded to Ron Smith in December 1979 and recorded on December 11, 1979, fourteen years and four months after the Arvin-Ransburg deed conveying the easement was recorded.¹³⁹

The Bartholomew Circuit Court determined that no easement existed because "the deed describing an easement in favor of plaintiffs' predecessors in title was outside the defendants' chain of title."¹⁴⁰ The Szakalys appealed.

The Smiths argue that in a state such as Indiana, where a grantor-grantee index system is used, a deed conveying an easement over land retained by the grantor, which is not recorded until after the recording of a deed out of the servient estate by the grantor, is outside the chain of title. Abstractors searching under a grantor-grantee system start their search in the grantor index with the person to whom the land was conveyed by the United States and continue to search under that person's

136. See CUNNINGHAM, *supra* note 61, § 11.11 at 796-802 for a more detailed discussion of the chain of title concept.

137. 525 N.E.2d 343 (Ind. Ct. App. 1988). After the survey period, the Indiana Supreme Court granted transfer. *Szakaly v. Smith*, 544 N.E.2d 490 (Ind. 1989). For a brief discussion of the supreme court opinion, see *infra* note 148.

138. 525 N.E.2d at 344.

139. *Id.*

140. *Id.*

name in the grantor index until a conveyance out from him is recorded. Any interests recorded during this period is within the chain of title. When the deed out is recorded, the abstractor stops the search under the name of the former owner and continues his search in the grantor index under the name of the new owner from the date he purchased the land to the date of the recording of a deed out from him. Only if the Arvin-Ransburg deed had been recorded promptly, before the Arvin-Allender deed, would the conveyance have been within the chain of title.¹⁴¹ As an aside, it should be noted that since Allender reconveyed to Isabelle Arvin the same day, a title searcher would have found the Arvin-Ransburg deed if it was recorded prior to a conveyance out by Isabelle Arvin.¹⁴² The Smiths argued that once out always out and that they had no constructive notice of the deed even though it was recorded fourteen years before they acquired title.¹⁴³

The court disagreed with the Smiths' chain of title argument, observing that by Indiana statute: [e]very conveyance . . . shall take priority according to the time of the filing thereof, and such conveyance . . . shall be fraudulent and void as against any subsequent purchaser . . . in good faith and for a valuable consideration, having his deed . . . first recorded.^{“¹⁴⁴}

141. *Id.* at 344-45.

142. Another interesting point, not addressed by the court, is raised by the fact that nowhere in the opinion is it stated when Isabella Arvin subsequently conveyed the title to the servient estate to a predecessor in the Smiths' chain of title. All that is indicated is that the Smiths acquired title to the servient estate in 1979 "after mesne conveyances." *Id.* at 344. Had Isabella Arvin conveyed the property prior to August 1965, when the Ransburg deed was recorded, the purchaser, assuming he or she paid value and was without actual notice of the easement, would have been a bona fide purchaser in good faith. Under the shelter principle, once title has passed to a bona fide purchaser in good faith, the bona fide purchaser can pass title to a subsequent grantees (other than the original grantor of the interest) even though the grantees has actual or constructive notice of an adverse interest purged by the operation of the recording act. See CUNNINGHAM, *supra* note 61, § 11.10 at 794; 4 AMERICAN LAW OF PROPERTY § 17.11, at 567-68 (Casner ed. 1952). Thus even though the easement was recorded prior to the conveyance to the Smiths, and even though its subsequent recordation would have been constructive notice to the Smiths, the conveyance to the bona fide purchaser would have cleared the title by operation of the recording act. CUNNINGHAM, *supra* note 61, § 11.10 at 794. Since this issue was not addressed by the court it must be assumed that Isabella Arvin was still the owner of the servient estate in August 1965 when the Ransburgs deed was recorded and thus all of the Smiths' predecessors in title would have been charged with constructive notice of the easement. The conveyance from the Arvins to Allender in 1957 would not pass title to the servient estate free of the easement even if Allender was a bona fide purchaser in good faith. The shelter rule, would not apply because the conveyance back was to one of the original grantors, Isabella Arvin, who had conveyed the easement to the Ransburgs.

143. 525 N.E.2d at 345.

144. *Id.* (emphasis supplied by the court) (quoting IND. CODE § 32-1-2-16 (1988)).

The court then cited *Hazlett v. Sinclair*,¹⁴⁵ for the position that a purchaser "is chargeable with knowledge of all information supplied by deeds either of his immediate or remote grantors" and concluded:

Indiana is one of the jurisdictions which recognize an exception to the rule that the record of a conveyance out of the line of title does not give constructive notice of its contents to innocent purchasers for value without notice.

. . . . The holding in *Hazlett* has the effect of charging grantees of servient tenements with knowledge of all the information supplied by the recorded conveyances of the common grantor.¹⁴⁶

In the context of the opinion, this quotation implies that the subsequent purchaser is on constructive notice of all deeds from a common grantor even if recorded after the conveyance out. This, however, may be a misreading of the scope of the *Hazlett* decision. In *Hazlett*, the easement was recorded during the time the grantor owned the land whose title was being searched. It involved a totally different issue: Whether the grant of an easement over tract A in a deed conveying tract B by a common grantor is notice to a subsequent purchaser of tract A? There is a split of authority as to whether a purchaser of tract A must examine the conveyances out of other tracts of land owned by a common grantor to ascertain whether or not the grantor may have given an interest in tract A in the conveyance of tract B.¹⁴⁷ *Hazlett* was merely indicating that in Indiana the purchaser of tract A is on notice of any interest in tract A transferred by a recorded conveyance from a common grantor. This does not, however, suggest that a subsequent purchaser of tract A would have to search under the name of a remote grantor of tract A after the deed out of tract A is recorded to see if a deed of tract B was subsequently recorded which granted an interest in tract A. Nevertheless, while the court may have misread *Hazlett*, there is substantial authority in states with a notice-race statute, such as Indiana,¹⁴⁸ holding that a subsequent purchaser takes subject to an interest in a deed recorded after the recording of a conveyance out by his grantor but before the recording by the subsequent pur-

145. 76 Ind. 488 (1881).

146. 525 N.E.2d at 346.

147. The decisions are about equally divided. See 4 AMERICAN LAW OF PROPERTY § 17.24, at 602 (Casner ed. 1952).

148. IND. CODE § 32-1-2-16 (1988) is a notice-race statute in that it requires not only that the subsequent purchaser be acting in good faith (without notice of the claim) and have paid valuable consideration, but further that his deed be first recorded.

chaser.¹⁴⁹ The argument is that the grantee must "record first" to win in a notice-race jurisdiction and the Arvin-Ransburg deed was recorded first.¹⁵⁰ The practical problem with this line of authority from an abstractor's point of view is that it requires a title search under the name of each grantor to continue down to the present in order to protect the purchaser against a prior interest recorded outside the chain of title. The time and cost involved in such a lengthy search of the records creates a heavy burden on purchasers when the loss could have been easily avoided by the prompt recording of all deeds.¹⁵¹

149. See CUNNINGHAM, *supra* note 61, § 11.11, at 800, which suggests that the decisions are about equally divided with more than half requiring a more detailed search. For an analysis of the cases under both notice and notice-race type statutes, see Philbrick, *Limits of Record Search and Therefor of Notice*, 93 U. PA. L. REV 125, 307-440 (1944) [article in 3 parts] [hereinafter *Philbrick*].

150. 4 AMERICAN LAW OF PROPERTY § 17.22, at 597-98 (Casner ed. 1952) (suggesting that even though the subsequent purchaser may be without notice he fails to meet the requirement of recording first under a notice-race statute). According to Professor Philbrick a purchaser who purchases after a claim is recorded (even after a deed out from the grantor) can never satisfy the requirement of recording first in a notice-race jurisdiction. *Philbrick*, *supra* note 149, at 391. Professors Dukeminier and Krier seem to question whether recording outside the chain of title is "recording" within the meaning of a recording statute. J. DUKEMINIER & J. KRIER, PROPERTY 734 (2d ed. 1988). In *Sabo v. Horvath*, 559 P.2d 1038 (Alaska 1976), a deed was recorded before a patent from the United States was issued to the grantor. In holding that the subsequent grantee was without notice of the prior recording and recorded first under Alaska's notice-race statute, the court remarked:

Because we want to promote simplicity and certainty in title transactions, we choose to follow the majority rule and hold that the [first] deed, recorded outside the chain of title, does not give constructive notice to the [second grantee] and is not duly recorded under the Alaskan Recording Act. Since [the second grantee's] interest is the first duly recorded interest . . . [second grantee] must prevail.

559 P.2d at 1044.

Thus, even under a notice-race statute a court can conclude that a recording outside the chain of title is not a recording within the meaning of the statute.

151. After the survey period, the Indiana supreme court granted transfer. *Szakaly v. Smith*, 544 N.E.2d 490 (Ind. 1989). In a thoughtful opinion by Justice Dickson, the court observed that since the servient estate had been reconveyed to Isabell Arvin and she was still the owner in 1965, when the deed to the dominant estate was recorded, subsequent purchasers taking from her were charged with notice of the easement, as the deed containing the easement would have been discovered in searching the grantor index under the name of Isabell Arvin. Thus, there was no need for the court of appeals to resort to the hypothesis that under *Hazlett v. Sinclair*, 76 Ind. 288 (1881) the Smiths were charged with constructive notice of all recorded deeds of their remote grantors. See discussion notes 142-47 *supra* and accompanying text. In fact, the supreme court rejected this interpretation of the *Hazlett* opinion: ". . . Hazlett does not establish that a grantor is charged with constructive knowledge of conveyances from a remote grantor that are outside of his chair of title. In light of *Rogers* and *Residence of Green Springs*

V. VENDOR AND PURCHASER: IMPLIED WARRANTY OF HABITABILITY EXTENDED TO NON-BUILDER DEVELOPER OF LAND

Traditionally, the purchaser of property was subject to the doctrine of *caveat emptor*.¹⁵² In 1972, Indiana recognized that a purchaser of a new home from a builder/vendor was entitled to rely upon an implied warranty of habitability.¹⁵³ By 1980 a substantial majority of jurisdictions had come to recognize an implied warranty of habitability in the sale of a new home by a builder/vendor.¹⁵⁴

In a number of jurisdictions, the warranty extends only to the first purchaser of the new home from the builder/vendor,¹⁵⁵ but in several jurisdictions, including Indiana, the builder/vendor's warranty has been extended to second or subsequent purchasers.¹⁵⁶ Similarly, the scope of the warranty of quality by the builder/vendor has been extended in many states beyond defects in the structure to defects in the land.¹⁵⁷ In states which have rejected the requirement of privity of estate for an action based on breach of the implied warranty of habitability, and which hold the scope of the warranty extends to defects in the land as well as the structure, the next logical step would be to extend the implied warranty to a developer, who knowing of a defect in the land making it unsuitable for homebuilding, sells the land to the builder-vendee.¹⁵⁸ Just such a situation arose in *Jordan v. Talaga*.¹⁵⁹

Valley Subdivision, we view the language in *Hazlett* as limited by the chain of title requirement." 544 N.E.2d at 492. The supreme court opinion eliminates the concerns expressed by this reviewer with regard to the court of appeals opinion and clarifies several areas of the law pertaining to title searches.

152. Haskell, *The Case For an Implied Warranty of Quality in Sales of Real Property*, 53 GEO. L.J. 633 (1965).

153. *Theis v. Heuer*, 264 Ind. 1, 280 N.E.2d 300 (1972).

154. Shedd, *The Implied Warranty of Habitability: New Implications, New Applications*, 8 REAL EST. L.J. 291, 302 (1980). A table of states and major court decisions at the end of the article indicates that by 1980 thirty-six (36) states and the District of Columbia had recognized an implied warranty of habitability in the sale of new homes by a builder/vendor, and of the remaining jurisdictions most had simply not addressed the issue. Only three states had directly or indirectly rejected an implied warranty of habitability in the sale of a new home. *Id.* at 303-06.

155. See, e.g., *Oliver v. City Builders, Inc.*, 303 So. 2d 466 (Miss. 1974); *Brown v. Fowler*, 279 N.W.2d 907 (S.D. 1979).

156. See *Barnes v. Mac Brown & Co.*, 264 Ind. 227, 342 N.E.2d 619. See also *Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969); *Redarowicz v. Ohlendorf*, 92 Ill. 2d 171, 441 N.E.2d 324 (1982).

157. See, e.g., *Hessen v. Walmsley Constr. Co.* 422 So. 2d 943 (Fla. Dist. Ct. App. 1982); *Lehmann v. Arnold*, 137 Ill. App. 3d 412, 484 N.E.2d 473 (appeal denied) (1985); *Banville v. Huckins*, 407 A.2d 294 (Me. 1979); *ABC Builders Inc. v. Phillips*, 632 P.2d 925 (Wyo. 1981).

158. A few decisions have held the developer liable to the subsequent purchaser

In *Jordan*, the homeowners, Thomas and Rebecca Talaga, brought suit against Daniel Jordan and Allie Baker, the developers of Sandridge Estates, a subdivision in Schererville, Indiana, for property damage caused by water and drainage problems under alternative theories of negligence and breach of implied warranty of habitability. The jury returned a general verdict in favor of the Talagas.¹⁶⁰

The developers platted, subdivided, and improved Sandridge Estates for the purpose of facilitating the building of homes. They rough graded the lots, put in sanitary sewers, storm sewers and streets.¹⁶¹ Although a natural watercourse ran along the border of the lot eventually purchased by the Talagas, the developers and an engineer employed by them concluded that enlarging an existing swale on the edge of the Talagas' lot would adequately handle the drainage problem and direct the flow of water into the street's storm sewers. A ten foot drainage easement, the only easement in the subdivision, was provided for in the plat to accommodate the swale.¹⁶² In June 1975, the lot in question was sold by the developers to Bruce Piper of Piper Enterprises, Inc., who built a tri-level home on the lot and sold it to the Talagas for \$42,000. Piper was aware of the drainage easement but did not know that the watercourse periodically swelled into a stream and did not experience any water problems during construction of the house. In February, 1976, the Talagas experienced water problems described by Piper as "Bad." Despite repeated efforts to correct the situation, the flooding problem continued.¹⁶³ A civil engineer testified that the water flowed from a pond on land owned by Britton over the Talagas' lot and a reasonable prudent developer would not have allowed a house to be built on such a lot.¹⁶⁴

On appeal, the developers raised nine issues, seven of which were addressed by the court.¹⁶⁵ The first issue raised was whether the Talagas

from the builder-vendor for defects in the land. See, e.g., *Avner v. Longridge Estates*, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969); *Hinson v. Jefferson*, 287 N.C. 422, 215 S.E.2d 102(1975); *Rusch v. Lincoln-Devore Testing Laboratory, Inc.*, 698 P.2d 832 (Colo. Ct. App. 1984).

159. 532 N.E.2d 1174 (Ind. Ct. App. 1989).

160. *Id.* at 1177.

161. *Id.* at 1178.

162. *Id.* The evidence was conflicting as to whether or not the swale was ever enlarged. *Id.*

163. *Id.* at 1178-79. The extent of the flooding problem and efforts to correct it are set forth in considerable detail throughout the opinion.

164. *Id.* at 1179.

165. Two issues pertaining to negligence were rendered moot when the court determined economic damages could not be recovered under a negligence theory. *Id.* at 1177. Several of the issues addressed by the court are not discussed in this review.

could recover economic damages under a negligence theory. After observing that the theory of negligence was designed to protect interests related to safety or freedom from harm, the court concluded that where there has been no accident and no physical damage, economic interests are not entitled to be protected against mere negligence: "to recover in negligence there must be a showing of harm above and beyond disappointed expectations."¹⁶⁶ Having said this, however, the court then determined that recovery could be allowed under an implied warranty of habitability theory.¹⁶⁷

The court next addressed the question of "[w]hether a *professional developer*, who *improves land* for the *express purpose* of *residential homebuilding* with *knowledge but without disclosure* of a *latent defect* in the real estate that renders the land *unsuitable* for the purpose of *residential homebuilding*, breaches an implied warranty of habitability."¹⁶⁸

The court observed that this was a question of first impression in Indiana, but noted that the neighboring state of Illinois had developed a line of cases addressing this issue. From an examination of these decisions, the court determined that although Illinois has held a builder/vendor liable for defects in the land as well as in the construction of the building,¹⁶⁹ it has refused to extend the implied warranty of habitability beyond the builder of a new home to one who sells the land to the builder.¹⁷⁰ The Illinois court reasoned that the subsequent purchaser of a home does not rely upon the expertise of the seller of the

166. *Id.* at 1181 (quoting *Redarowicz v. Ohlendorf*, 92 Ill. 2d 171, 411 N.E.2d 324 (1982)).

167. *Id.* at 1182.

168. *Id.* at 1182 (emphasis added).

169. *Id.* at 1183. In *Briarcliffe West Townhouse Owners Ass'n v. Wiseman Constr. Co.*, 118 Ill. App. 3d 163, 454 N.E.2d 363 (1983), the court held that defects in common land could affect the habitability of townhouses. The court concluded that there is no real distinction between defects in the building and defects in the land because in either case the purchaser must rely upon the expertise of the builder-vendor.

170. 532 N.E.2d 1174 at 1183-84. In *Lehmann v. Arnold*, 137 Ill. App. 3d 412, 484 N.E.2d 473 (appeal denied) (1985), under a similar factual situation, the Illinois court refused to extend the implied warranty of habitability to the developer who sold the unimproved land subject to periodic flooding to the builder/vendor. The court relied in part on an earlier Illinois appellate decision, *Kramp v. Showcase Builders*, 97 Ill. App. 3d 17, 422 N.E.2d 958 (1981), which dismissed a suit against the non-builder developer of the subdivision (soil conditions were inadequate for installation and operation of their septic systems). While a subsequent Illinois supreme court decision, *Redarowicz v. Ohlendorf*, 92 Ill. 2d 171, 441 N.E.2d 324 (1982), extended the warranty to allow subsequent purchasers of the home to recover against the builder/vendor for latent defects, the *Lehmann* court did not believe the *Redarowicz* decision, doing away with the privity of estate requirement, extended the class of defendants beyond the builder/vendor.

land, but instead relies upon the skill of the builder to insure that the home built on the property will be habitable.¹⁷¹ While impressed with the rationale of the Illinois decisions, the Indiana Court of Appeals concluded that the application of the doctrine of *caveat emptor* would work "a manifest injustice" in this case.¹⁷² The developers had done more than sell raw land. They had improved the land for development of a subdivision. They were aware of the water problem and were in the best position to leave the lot undeveloped.¹⁷³ To apply the doctrine of *caveat emptor* would vest "unscrupulous developers . . . with impunity to develop marginal and unsuitable land."¹⁷⁴ Thus the court of appeals affirmed the verdict upon the theory that a developer who improves land for the express purpose of residential homebuilding with knowledge of a latent defect in the real estate which renders it unsuitable for the purpose of residential homebuilding breaches an implied warranty of habitability.¹⁷⁵

The developers next argued that the buyers had failed to give them timely notice and a reasonable opportunity to cure the defect. The court agreed that, before a purchaser can recover for breach of an implied warranty of habitability, he must at least inform the vendor of the problem and give him an opportunity to correct it, but the court determined that in this case the Talagas had informed Jordan immediately after the problem revealed itself.¹⁷⁶ Likewise, the Talagas appealed to the town of Schererville regarding the problem at a time when Baker was an official of the town.¹⁷⁷

The developers also claimed that the award of \$74,000 damages was excessive. Since the Talagas had paid only \$42,500 for the house, the jury's award was based on the market value at the time of trial and not the purchase price. The court observed that:

[T]he measure of damages appropriate for recovery under an implied warranty of habitability should be analogous to the measure of damages recoverable under an implied warranty of merchantability, that is the difference between the value as warranted less the value at the time of acceptance plus incidental and consequential damages.¹⁷⁸

171. 532 N.E.2d at 1184 (quoting *Lehmann*, 484 N.E.2d at 477).

172. 532 N.E.2d at 1184.

173. *Id.* at 1185.

174. *Id.* at 1186.

175. *Id.* at 1186.

176. In *Wagner Constr. Co. v Noonan*, 403 N.E.2d 1144 (Ind. Ct. App. 1980), the Indiana court of appeals held that the purchaser must inform the vendor of the problem and give him a reasonable opportunity to correct it. *Id.* at 1150.

177. *Jordan*, 532 N.E.2d at 1186-87.

178. *Id.* at 1187.

While the instruction to the jury set forth an inappropriate tort theory of damages,¹⁷⁹ the error had not been preserved because the developers failed to object to the instruction.¹⁸⁰ The court also concluded that an award of prejudgment interest was appropriate because the deprivation of one's home is similar to the deprivation of the use of money.¹⁸¹

This case should not be read too broadly. It does not suggest that a seller of unimproved land warrants that it is fit for any intended use by the purchaser absent misrepresentation or fraud. The case appears to limit the implied warranty to situations where a developer has improved the land for residential homebuilding and is aware of a latent defect which renders the land unsuitable for such purpose.¹⁸²

179. The instruction to the jury with regard to damages stated:

Where real property is destroyed or the enjoyment of the use of said property significantly impaired, the measure of damages is the difference in the fair market value of the real estate before and after the destruction or damage. The measure of damages for nonpermanent injury to real estate equals the cost of restoration. *Id.* at 1187.

180. *Id.* at 1188.

181. *Id.* at 1187 (citing *Fort Wayne Nat'l Bank v. Scher*, 419 N.E.2d 1308 (Ind. Ct. App. 1981)).

182. 532 N.E.2d at 1184-85. The court noted that in *Witty v. Schramm*, 62 Ill. App. 3d 185, 379 N.E.2d 333 (1978), the developers of the unimproved lot were not charged with knowledge of the defective condition (excessive subsurface water). The court concluded that: "Apparently, special knowledge of the defect would have imposed a duty upon the developer to repair or correct." 532 N.E.2d at 1185. Likewise, the court found a similar lack of knowledge in *Cook v. Salishan Properties, Inc.*, 279 Or. 333, 569 P.2d 1033 (1977), where the court refused to impose an implied warranty of habitability upon the lessor/developers of unimproved seaside lots. Finally, the court suggested that knowledge of the conditions of the land was a factor in imposing an implied warranty of habitability upon the seller of unimproved land in *Rusch v. Lincoln-Devore Testing Laboratory, Inc.*, 698 P.2d 832 (Colo. App. 1984) (unimproved lot on the site of a manmade fill).

Estate Planning: The Use of Irrevocable Life Insurance Trusts

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The creation of an irrevocable life insurance trust has become an established and commonly used federal estate planning technique. In fact, due to recent changes in the tax laws, an irrevocable life insurance trust remains one of the few viable methods to reduce federal estate tax. An irrevocable trust funded with life insurance provides the opportunity to create wealth for the benefit of the settlor's family without the imposition of federal estate tax and to provide liquidity for the estate of the settlor.

While Congress has periodically considered and ultimately rejected the notion of subjecting the internal cash build-up of life insurance to federal income taxation, recent revisions of the Internal Revenue Code of 1986, as amended ("Code"), and administrative pronouncements issued by the Internal Revenue Service ("IRS") during the survey period covered by this publication have significant estate tax ramifications relating to the creation and implementation of an irrevocable life insurance trust. This discussion is limited to the factual situation in which an irrevocable trust is funded solely with insurance policies on the settlor's life, of which the trust is the owner and beneficiary.

I. RECENT DEVELOPMENTS

There are certain emerging concerns that may affect the viability of an irrevocable life insurance trust. The provisions of new Code section 2036(c), enacted as part of the Omnibus Budget Reconciliation Act of 1987 and as amended under the Technical and Miscellaneous Revenue Act of 1988, conceivably could apply to and restrict the use of irrevocable life insurance trusts. Code section 2036(c) was specifically adopted to nullify certain estate planning techniques used to "freeze" the value of

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business and investment assets for estate tax purposes.¹ Prior to the passage of Code section 2036(c), the freeze was accomplished by allocating future appreciation in such assets to family members in a younger generation, generally by means of a preferred stock recapitalization or a multi-class partnership.² However, the broad concepts and expansive language of Code section 2036(c) arguably encompass certain aspects of the traditional irrevocable life insurance trust.

The fair market value, determined as of the date of the death of the transferor, of any transfer within the purview of Code section 2036(c) is included in the transferor's taxable estate, regardless of the duration of time between such transfer and the death of the transferor.³ The definitional elements of a transfer subject to the provisions of Code section 2036(c) are as follows: (1) The transferor holds a substantial interest in an "enterprise"; (2) the transfer embodies a disproportionately large share of the potential appreciation in the interest of the transferor in the enterprise; and (3) the transferor retains an interest in the income of, or right in, the enterprise.⁴

Code section 2036(c) is of concern in the context of an irrevocable life insurance trust because of the spousal unity rule in subsection 3(C) thereof.⁵ The spousal unity rule, by definition, treats spouses in all respects as one person for purposes of this statute.⁶ Therefore, if a life insurance policy can be classified as an enterprise, then the transfer of the policy to an irrevocable life insurance trust in which the spouse of the settlor is granted an income interest and/or Crummey power⁷ exercisable during the life of the settlor triggers the application of Code section 2036(c), resulting in the proceeds of such life insurance policy being included in the taxable estate of the settlor.⁸

The analysis as to whether a life insurance policy is an enterprise and thus subject to the provisions of Code section 2036(c) was frustrated by the fact that the term "enterprise" was not defined in the statute. The attempt to discern the scope of this term by reference to congressional

1. See generally Adams, Herpe & Abendroth, *Technical Corrections Cause New Tremors and Aftershocks*, 128 Tr. & Est. 39 (1989); Bettigole, *Use of Estate Freeze Severely Restricted by Revenue Act of '87*, 68 J. TAX'N 132 (1988); Blattmachr & Gans, *An Analysis of the TAMRA Changes to the Valuation Freeze Rules* (parts 1 & 2), 70 J. TAX'N 14, 74 (1989); Schachne & Barasch, *More on Avoiding the Grasp of Section 2036(c)*, 128 Tr. & Est. 37 (1989).

2. See sources cited *supra* note 1.

3. I.R.C. § 2036(a)(1989).

4. *Id.* § 2036(c)(1)(A), (B).

5. *Id.* § 2036(c)(3)(C).

6. *Id.*

7. See *infra* notes 40-45 and accompanying text.

8. I.R.C. §§ 2036(c)(1), (3)(C) (1989).

intent as documented in underlying committee reports has not been informative. However, this concern has been temporarily relieved by the issuance on September 18, 1989, of Internal Revenue Notice 89-99, which specifically stated that a life insurance policy is personal use property and thus outside the scope of Code section 2036(c).⁹

Reliance on Notice 89-99 in the creation of an irrevocable trust is tempered by the fact that it is an administrative pronouncement, the terms of which can be modified, amended or superseded at any time by the issuance of regulations by the IRS concerning this matter. In addition, according to footnote 18 of this notice, funding an irrevocable life insurance trust in excess of the premium requirements of the policy held in trust would cause the trust to become an enterprise with respect to such excess funds.¹⁰

An additional concern threatens the economic bases underlying life insurance in general and an irrevocable life insurance trust in particular. Recent tax proposals considered by Congress have had provisions that would subject the internal cash build-up of a life insurance policy to income taxation. Such a provision would impose income tax liability on an unfunded irrevocable life insurance trust and those beneficiaries holding Crummey powers in the trust, unless the policy held by the trust is a term plan. While such proposals have been vigorously opposed by the insurance industry and have not become law, there can be no assurance that the federal government will continue to exempt this significant potential revenue source from income taxation.

II. ATTRIBUTES OF AN IRREVOCABLE LIFE INSURANCE TRUST

An irrevocable life insurance trust may be drafted so that the policy proceeds will not be included in the taxable estates of the settlor and his¹¹ spouse, subject to the "three year rule."¹² This type of trust is especially useful for a second to die policy on the lives of the settlor and his spouse under current federal estate tax laws, because their estates may be planned so that the estate tax is payable only upon the death of the second spouse. This Article does not address the generation-skipping transfer tax under Code sections 2601 to 2663, as its application is dependent upon the dispositive terms of the trust agreement.

In addition to the proceeds of a life insurance policy owned by an irrevocable trust being removed from the taxable estates of the settlor,

9. I.R.S. Notice 89-99, 1989-38 I.R.B. 4.

10. *Id.* at n.18.

11. The use of masculine pronouns shall be deemed masculine or feminine, as appropriate.

12. See *infra* notes 28-30 and accompanying text.

the post death payment of the insurance proceeds will be exempt from income taxation by application of section 101(a) of the Code, unless the "transfer for value" provisions of the Code are applicable.¹³ Such death proceeds provide a source of funds which may, in the discretion of the trustee, be loaned to the settlor's estate or used to purchase estate assets, thereby providing liquidity for the payment of death taxes and other liabilities of his estate.

As does any trust, an irrevocable life insurance trust may also provide certain non-tax benefits, including the following: (1) control over disposition of the income and corpus of the trust; (2) professional management of the trust corpus; (3) avoidance of guardianships for minors or incompetent beneficiaries of the trust; (4) insulation of the trust corpus from the claims of creditors or dissipation by the beneficiaries; and (5) avoidance of probate of trust assets. However, an irrevocable life insurance trust, by definition, is not easily amended or revoked should the settlor desire for reasons such as changes in financial or personal circumstances and wishes, revisions of the Code or other extrinsic factors. In addition, the settlor no longer has ownership of any insurance policy he transferred to the trust. Thus, if the settlor later decides not to fund the premium by annual contributions to the trust, because the trust terms no longer fulfill his desires, but then wishes for such policy to remain in force, ownership of the policy must be transferred from the trust. This transfer may present certain tax and practical problems, including the possible application of the transfer for value rule,¹⁴ the determination of the purchase price for such policy, and distribution of any remaining corpus.

Code section 2036(a)(1) mandates that the corpus of any trust be included in the estate of the settlor, if he retains, for life or for any period not ascertainable without reference to his death or which does not in fact end before his death, any right, directly or indirectly, to the income of the trust or to any enjoyment of the benefits of trust corpus.¹⁵ Consequently, if during the lifetime of the settlor, an irrevocable life insurance trust may benefit the settlor or be used to discharge support obligations of the settlor, the corpus of the irrevocable trust will be included in his taxable estate. Therefore, the trust agreement should specifically preclude, during the settlor's lifetime, the use of any trust property for the benefit of the settlor or for the payment of his support obligations.

Additionally, even if the corpus of the trust is not included in the taxable estate of the settlor, retention by the settlor of any incident of

13. See *infra* notes 25-27 and accompanying text; see also I.R.C. § 101(a)(2) (1989).

14. See *supra* note 12.

15. I.R.C. § 2036(a)(1) (1989).

ownership in a life insurance policy transferred to an irrevocable life insurance trust will cause the face amount of such policy to be included in his taxable estate.¹⁶ Incidents of ownership are rights or interests in a life insurance policy whereby the settlor has the power, directly or indirectly, to: (1) control the existence of the policy; (2) revise or rearrange the economic interests therein; or (3) effect the policy benefits.¹⁷ The mere retention of the power to veto the disposition of a life insurance policy is sufficient to cause the proceeds to be included in the taxable estate of the settlor.¹⁸

There has been a split of opinion as to whether an interest in a life insurance policy exercised by the settlor of an irrevocable life insurance trust solely in a fiduciary capacity, as trustee of the trust, constitutes an incidence of ownership under Code section 2042.¹⁹ The IRS has acknowledged that the exercise of such power by the settlor in his capacity as a trustee of an irrevocable life insurance trust may not expose the settlor to estate tax liability provided (1) the settlor acquired the power after he had divested himself of all interests in the policy; and (2) the trust precludes the exercise of the power for the personal benefit of the settlor.²⁰ Therefore, the settlor should neither be the trustee nor retain any incident of ownership in any insurance policies on his life.

However, even if the settlor never held any incidents of ownership in an insurance policy on his life or paid any premiums in connection therewith, the proceeds of the life insurance policy would still be included in his estate to the extent that such funds are restricted to the discharge of estate obligations.²¹ In order to insure that the tax benefits of an irrevocable life insurance trust are preserved, the trust agreement should provide that the trustee may, but is not directed to, use the proceeds of a life insurance policy held in trust to satisfy the death taxes and other liabilities of the estate of the settlor.

III. FUNDING THE TRUST

An irrevocable life insurance trust may be funded by the issuance of a new policy on the settlor's life applied for by the trust or the transfer to the trust of an existing policy on his life.

16. *Id.* § 2042(2).

17. Treas. Reg. § 20.2042-1(a)(2) (as amended in 1974).

18. *Id.* § 20.2042-1(c)(4) (as amended in 1972).

19. See, e.g., *Rose v. United States*, 511 F.2d 259 (5th Cir. 1975); *Estate of Skifter v. Commissioner*, 468 F.2d 699 (2d Cir. 1972); *Estate of Fruehauf v. Commissioner*, 427 F.2d 80 (6th Cir. 1970).

20. Rev. Rul. 84-179, 1984-2 C.B. 195.

21. Treas. Reg. § 20.2042-1(b)(1) (as amended in 1974).

A. *Issuance of New Policy*

To avoid the transfer for value rule²² and the three year rule,²³ an irrevocable life insurance trust may be funded by the issuance to the trust of a new policy on the life of the settlor. The application for the life insurance policy would be submitted by the trustee, naming the trust the designated owner and beneficiary of the policy. Thus, the trust would be the owner and beneficiary of the insurance policy on the settlor's life at the time it is issued. This means of funding an irrevocable trust is only feasible if the settlor is insurable, at a reasonable premium, at the time the trust is created.

B. *Transfer of Existing Policy*

The transfer of a life insurance policy owned by the settlor on his life to an irrevocable trust effectively removes the full face amount of the policy from his taxable estate, provided the settlor survives the transfer by three years. By such transfer or assignment, the settlor is deemed to have made a completed gift to the trust beneficiaries, the fair market value of which is subject to gift tax at the time of transfer.²⁴

In addition, by borrowing against the policy prior to its assignment to an irrevocable trust, the settlor can control the value of the transfer subject to gift tax. Consequently, the gift of a life insurance policy may be planned to subject the settlor to little, if any, gift tax liability. Furthermore, unless a life insurance policy has significant cash value which was not borrowed prior to its assignment to an irrevocable life insurance trust, the assignment of the policy does not deprive the settlor of the use or control of an asset having substantial current value or benefit.

If an irrevocable life insurance trust is to be funded by transfer of an existing life insurance policy, it is imperative that the transaction be structured in such a manner as to avoid the imposition of the "transfer for value rule."²⁵ Under the transfer for value rule, the proceeds of a life insurance policy purchased for its fair market value are subject to

22. See *infra* notes 25-27 and accompanying text.

23. See *infra* notes 28-30 and accompanying text.

24. Treas. Reg. § 25.2511-1(a) (as amended in 1983) (the value for gift tax purposes of an unmatured premium paying whole life policy is its interpolated terminal reserve value increased by any unearned or prepaid premiums and/or dividend accumulations, and reduced by any outstanding policy loans). The gift tax value of a single premium or paid-up policy is the single premium which would be charged for the issuance of a comparable policy based on the insured's age at the time of the gift. Treas. Reg. § 25.2512-6(a) (as amended in 1963).

25. I.R.C. § 101(a)(2) (1989).

income taxation, to the extent such proceeds exceed the sum of the consideration paid by the transferee in acquiring the policy and the amount of subsequent premiums paid.²⁶

However, the transfer for value rule has two important exceptions, one of which is relevant to the acquisition of an existing life insurance policy by an irrevocable trust. The transfer for value rule does not apply when the basis of the policy in the hands of the transferee is determined in whole, or in part, by reference to its basis in the hands of the transferor (*e.g.*, the transfer is a gift in whole or in part).²⁷ Therefore, if the proceeds of a life insurance policy are to be totally exempt from income taxation, an existing life insurance policy must be acquired by the irrevocable trust, at least in part, by gift. In most cases the settlor merely transfers by gift an insurance policy on his life to the irrevocable trust, after borrowing any cash value, which avoids the application of the transfer for value rule.

While the Economic Recovery Tax Act of the 1981 ("ERTA") limited the application of Code section 2035 for decedents dying after 1981,²⁸ Congress did retain the "three year rule"²⁹ for gifts of life insurance. Under the three year rule, the estate of a decedent includes the proceeds of all insurance policies transferred by him within three years of his death.³⁰

The three year rule also presented a potential barrier to the use of group term insurance to fund an irrevocable trust. Because term insurance is renewed periodically (annually for most group master policies), there has been some concern as to whether each renewal constitutes a new transfer by the settlor of his interest in the policy. If so, annually renewable group term life insurance assigned to a trust would always be included in the estate of a decedent by application of Code section 2035(d).

In Revenue Ruling 82-13, the IRS reversed its original position and held that the automatic renewal of a master policy of group term insurance will not be considered purchases of new policies by the insureds, so long as evidence of insurability is not required.³¹ Furthermore, a change in insurance carriers by an employer within three years of the death of the insured does not cause the proceeds from the group policy to be included in the taxable estate of the insured, provided that the group policies are virtually identical and the original assignment of the

26. *Id.*

27. *Id.* § 101(a)(2)(A).

28. *Id.* § 2035(d)(1).

29. *Id.* § 2035(d)(2).

30. *Id.*

31. Rev. Rul. 82-13, 1982-2 I.R.B. 9.

interest of the insured was made more than three years before his death.³² Therefore, the assignment of group term insurance remains a viable method of funding an irrevocable life insurance trust.

IV. PAYMENT OF PREMIUMS

Prior to the enactment of ERTA, the proceeds of a life insurance policy were included in the estate of the settlor if the policy was issued to a trust at his direction within three years of his death for which he paid the premiums, directly or indirectly.³³ Recent Tax Court decisions interpreting new Code section 2035(d) have held that the payment by a decedent of premiums on a life insurance policy on his life, issued within three years of the date of his death, is not the controlling factor in determining whether the proceeds of such a policy are included in his taxable estate.³⁴ Rather, the Tax Court has held that the dispositive issue under subsection (d) is whether the decedent possessed any incidents of ownership in the policy during the three year period prior to his death.³⁵ However, the transfer of funds to an irrevocable trust for the payment of life insurance premiums must still be structured properly to avoid adverse gift tax consequences.

A. Crummey Powers

Transfers to an irrevocable trust of funds for the payment of the premiums on a life insurance policy held in trust represent completed gifts to the trust beneficiaries, and subject the donor to gift tax liability.³⁶ Such transfers are generally considered gifts of future interests because the right of the trust beneficiaries to receive property from the trust is

32. Rev. Rul. 80-289, 1980-2 C.B. 170.

33. In *Bel v. United States*, 452 F.2d 683 (5th Cir. 1971), the payment by the decedent of the initial premium on a life insurance policy on his life was characterized as a constructive transfer of the ownership of the policy for purposes of I.R.C. § 2035, even though the decedent never possessed any ownership interest in such policy. The rationale of *Bel* was applied in the context of an irrevocable life insurance in *Estate of Kurihara v. Commissioner*, 82 T.C. 51 (1984), wherein a monetary gift by the decedent within three years of his death to a trust and used by the trustee to pay the initial premium on a life insurance policy on the life of the decedent owned by the trust constituted sufficient basis for the proceeds of the policy to be included in the estate of the decedent.

34. See, e.g., *Estate of Leder v. Commissioner*, 89 T.C. 235 (1987), aff'd, 893 F.2d 237 (10th Cir. 1989); *Estate of Headrick v. Commissioner*, 93 T.C. 18 (1989); *Estate of Chapman v. Commissioner*, 56 T.C.M. (CCH) 1415 (1989).

35. *Leder*, 89 T.C. at 235. However, the IRS has not accepted this position and recently prevailed in a federal district court on this issue, in a decision in which *Leder* was not mentioned. *Hardwood v. U.S.* ____ F. Supp. ____ (S.D. Fla. 1989).

36. Treas. Reg. § 25.2511-1(a) (as amended in 1983).

either not immediate or is at the discretion of the trustee.³⁷ Even if trust beneficiaries are given a present income interest, no exclusion is available if an irrevocable trust holds only a life insurance policy that produces no income or all of the income held by the trust must be used to pay premiums.³⁸ Consequently, it is essential that the trust agreement be drafted in such a manner so that these transfers to the irrevocable life insurance trust constitute gifts of a present interest which qualify under Code section 2503(b) for the annual gift tax exclusion of up to \$10,000 per year per donee.³⁹

The traditional method for transforming conveyances to an irrevocable life insurance trust into gifts of a present interest is to provide that such transfers are subject to a "Crummey" power of withdrawal. The designation of such withdrawal rights as Crummey powers derived from *Crummey v. Commissioner*,⁴⁰ the case in which the Court of Appeals first held that as a transfer to a trust subject to limited withdrawal rights transformed the conveyance into a gift of a present interest for gift tax purposes.⁴¹ A Crummey power gives the powerholder an immediate right to withdraw transfers to the trust, even though the power is not intended by the settlor to be exercised.⁴² The Crummey power attaches to each transfer made to the trust, but lapses if not exercised within a limited time period.⁴³ The right of a Crummey powerholder to withdraw funds transferred to an irrevocable life insurance trust transforms such conveyances into gifts of present interests for gift tax purposes.⁴⁴ Even if the Crummey power is held by a minor for whom no guardian has been appointed, the gift tax exclusion will be allowed so long as there is no impediment under the trust agreement or local law to the appointment of a guardian for such purpose.⁴⁵

Obviously, the settlor does not intend that a Crummey power be exercised; to do so would undermine the very purpose for which the irrevocable life insurance trust was created. In order to minimize the possibility, the period of time during which such power can be exercised is expressly limited by the provisions of the trust agreement. The shorter

37. Rev. Rul. 79-47, 1979-1 C.B. 312; Treas. Reg. § 25.2503-3 (as amended in 1983).

38. Treas. Reg. § 25.2503 (as amended in 1983).

39. The annual gift tax exclusion is presently \$10,000 per year per donee; however, if the spouse of the donor consents to "split" the gift, an amount of up to \$20,000 per year per donee may be gifted without subjecting the donor to any gift tax liability.

40. 397 F.2d 82 (9th Cir. 1968).

41. *Id.* at 88.

42. *Id.*

43. *Id.* at 83, 88.

44. *Id.* at 88.

45. *Naumoff v. Commissioner*, 46 T.C.M. (CCH) 852 (1983).

the duration of the life of the Crummey power, the less likelihood that such power will be exercised. IRS pronouncements have indicated that as little as four days between the notice of the transfer of property to an irrevocable life insurance trust and the expiration of the Crummey power to withdraw such property is sufficient to transform such transfer into a gift of a present interest, qualifying for the gift tax exclusion.⁴⁶ Notwithstanding, a three day period in which to exercise a Crummey power has been found to be an unreasonable impediment, resulting in the denial of the annual gift tax exclusion.⁴⁷

The holder of a Crummey power must have actual notice of the transfer of property to the trust, as well as a reasonable opportunity to exercise such withdrawal right prior to its lapse, if such a conveyance is to qualify for the annual gift tax exclusion.⁴⁸ IRS private letter rulings regarding irrevocable life insurance trusts have allowed the delivery to the Crummey powerholders of a schedule of future premium payments to serve as "continuing notice" to persons holding Crummey powers.⁴⁹

The trust agreement may even provide that the settlor may, from time to time, stipulate that a transfer is not subject to withdrawal by a certain Crummey powerholder.⁵⁰ Such a provision would enable a settlor to continue to fund an irrevocable trust in the event of a threatened or actual exercise of a Crummey power of withdrawal. However, by so stipulating, the settlor would not be entitled to the gift tax exclusion for any such restricted Crummey powerholder.⁵¹

In order for a Crummey withdrawal right to constitute a valid present interest, the property to which it attaches must be in, or converted to, a form that can be withdrawn by the powerholder. If such funds are not readily accessible by the Crummey powerholder, his withdrawal rights could be perceived as illusory and thus subject to challenge.⁵² The issuance by the settlor of a check made payable to the trustee for payment of a periodic premium on a life insurance policy held in trust does not create a liquid fund against which the powerholder could exercise his Crummey withdrawal right.⁵³ Until such check is cashed by the trustee, it could be asserted that the gift is incomplete because the settlor still retains dominion and control over the funds.⁵⁴ Therefore, property trans-

46. Priv. Ltr. Rul. 79-22-107 (Mar. 5, 1979).

47. Tech. Adv. Mem. 79-46-007 (July 26, 1979).

48. Rev. Rul. 81-7, 1981-1 C.B. 474; Priv. Ltr. Rul. 81-26-047 (Mar. 31, 1981).

49. Priv. Ltr. Rul. 81-33-070 (May 21, 1981); Priv. Ltr. Rul. 81-21-069 (Feb. 26, 1981).

50. See, e.g., *Estate of Edmonds v. Commissioner*, 72 T.C. 970 (1979).

51. *Id.*

52. *Estate of Kurihara v. Commissioner*, 82 T.C. 51 (1984).

53. *Id.*

54. *McCarthy v. United States*, 806 F.2d 129 (7th Cir. 1986).

ferred to an irrevocable trust should be reduced to cash or liquid investment and maintained in an account of the trust throughout the Crummey withdrawal period.

Another important element in drafting an irrevocable trust agreement is deciding to what extent and to whom Crummey powers should be granted. Because the donor of property to an irrevocable life insurance trust is entitled to a gift tax exclusion for each powerholder, it is possible to shelter the full amount of any transfer to such a trust from the imposition of the gift tax merely by naming a sufficient number of Crummey powerholders. For this reason, it was common practice for persons to be designated Crummey powerholders in an irrevocable trust agreement, even though they were not otherwise beneficiaries of the trust.

This practice is generally not used today, because of a recent private letter ruling.⁵⁵ In this ruling, the IRS disallowed gift tax exclusions relating to those persons who held Crummey powers in an irrevocable trust, but who were not vested beneficiaries of the trust.⁵⁶ The IRS asserted that the mere grant of a Crummey power of withdrawal does not endow the powerholder with a "sufficient interest" in an irrevocable trust for the annual gift tax exclusion to apply, unless and only to the extent that such withdrawal right is actually exercised.⁵⁷ To date, however, there has been no guidance from the IRS with respect to what constitutes a sufficient interest in an irrevocable trust for purposes of qualifying a Crummey power for the annual gift tax exclusion.

B. Lapse of Crummey Power

The right to withdraw property from a trust by a holder of a Crummey power is deemed a general power of appointment for federal transfer tax purposes.⁵⁸ The lapse of such a power is treated as a taxable transfer by the powerholder to the trust beneficiaries, to the extent that the property reachable by the power exceeds the greater of \$5,000 or 5% of the total value of the property subject to appointment ("5 and 5 Rule").⁵⁹

In order to preserve the corpus of an irrevocable life insurance trust, Crummey powers generally are drafted in the trust agreement so as to attach only to the periodic transfers, not the accumulated corpus of the irrevocable trust. Under such a provision, the 5% lapse limitation would

55. Priv. Ltr. Rul. 87-27-003 (Mar. 16, 1987).

56. *Id.*

57. *Id.*

58. See, e.g., *Quatman v. Commissioner*, 54 T.C. 339 (1970).

59. Priv. Ltr. Rul. 89-01-004 (Sept. 16, 1988).

only be applicable if a transfer to an irrevocable life insurance trust, either in the form of the initial assignment of a life insurance policy or the transfer of funds for the subsequent payment of the premiums, exceeded \$100,000. This is a rather remote possibility given the technique discussed above for reducing the value of a life insurance policy to be transferred to the trust by means of a policy loan and the option to fund a life insurance policy by payment of periodic premiums. Therefore, with respect to the vast majority of irrevocable life insurance trusts, the lapse of a Crummey power to withdraw trust property in excess of \$5,000 will subject the designated Crummey powerholder or his estate to liability for gift or estate taxes, respectively, even though he did not receive any funds from the trust with which to pay these taxes.

As a result of the difference between the annual gift tax exclusion of \$10,000 per person and the \$5,000 limitation relating to the lapse of a general power of appointment, there is an inherent conflict between the settlor and the Crummey powerholders in an irrevocable life insurance trust with respect to the grant of Crummey powers in excess of \$5,000. The settlor of an irrevocable life insurance trust generally desires that each Crummey powerholder be granted in the trust agreement the right to withdraw annually a portion of the property transferred to the trust up to the maximum annual gift tax exclusion amount, presently \$10,000. Conversely, the Crummey powerholder does not want the power to exceed \$5,000 annually, so that the lapse of such power will not expose him to any gift tax liability.

Drafters of irrevocable life insurance trust agreements have attempted to resolve or, at least, minimize the conflict by the use of several different approaches. A common practice is to specifically limit the annual amount of property which may be withdrawn by each Crummey powerholder to the greater of \$5,000 or 5% of the value of the property transferred. Although such a limited grant reduces the annual exclusion available to the settlor with respect to each powerholder and, therefore, may necessitate the appointment of more powerholders, it does insure that the lapse of a Crummey power will not impose any gift tax liability on the powerholder.

A second approach eliminates the potential gift tax liability by giving each powerholder a special testamentary power of appointment over the property transferred to the trust which causes any gift that results from the lapse of the Crummey power to be incomplete. Nevertheless, the grant of a testamentary power of appointment may only defer the recognition of the taxable transfer. Code section 2041(a)(2) requires the inclusion of a pro-rata portion of the trust in the taxable estate of any Crummey powerholder who dies holding a testamentary power of appointment while the trust is still in existence.⁶⁰ Therefore, in order to minimize this potential

60. I.R.C. § 2041(a)(2) (1989).

estate tax liability resulting from a lapse of a Crummey power, a testamentary power of appointment is generally granted only to those Crummey powerholders whose life expectancies are significantly greater than that of the settlor.

A third alternative has been to provide in the trust agreement that such Crummey powers lapse only to the extent of the amount protected by the 5 and 5 Rule; the power to withdraw amounts in excess of the statutory limitation remains in force. These open powers are commonly referred to as "hanging powers"⁶¹ and are subject to lapse in future years to the extent then permitted under the 5 and 5 Rule. Hanging powers are particularly well suited to life insurance policies based on limited premium paying periods (i.e., minimum deposit, limited pay life or vanishing premium). In this regard, hanging powers are superior to testamentary powers of appointment. While both alternatives effectively preclude the imposition of a gift tax on the lapse of a Crummey power, only the hanging powers provide a mechanism for reducing or eliminating the resulting estate tax liability during the term of the trust.

However, in a recent private letter ruling, the IRS disregarded the hanging Crummey power provisions in an irrevocable trust agreement and held that the lapse of a Crummey power resulted in a current taxable gift by the powerholder of the full amount of the property subject to the power in excess of the amount protected by the 5 and 5 Rule.⁶² The IRS reasoned in this instance that the hanging Crummey powers constituted non-quantifiable conditions subsequent that frustrated the determination of the gift tax liability and rendered examination of the gift tax return ineffective; and thus, were invalid.⁶³ Therefore, certain tax risks exist regarding the use of the hanging Crummey power until this issue is resolved.

V. CONCLUSION

This Article is not intended to be an exhaustive analysis of the matters discussed herein, or a comprehensive study of all issues relating to the use of irrevocable life insurance trusts. Rather, the intent is to convey a sense of the complex and dynamic factors which affect and should be considered in deciding whether to create this type of trust. The use of such an instrument with its irrevocable character requires careful analysis. The favorable federal estate tax consequences of an irrevocable life insurance trust make it an important consideration in the formation of an estate plan. Because the laws governing irrevocable

61. Covey, *Powers of Withdrawal*, ____ PRAC. DRAFTING ____ (1982).

62. Priv. Ltr. Rul. 89-01-004 (Sept. 16, 1988).

63. *Id.*

life insurance trusts are complex and subject to change, they must be monitored in order to determine if they adversely affect the benefit of this estate planning technique.

Survey of Recent Developments in Indiana Taxation Law

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I. INTRODUCTION

During the survey period there were several significant developments in Indiana taxation. The general reassessment of all real property, which commenced on July 1, 1987, continued into 1989 and will be the basis for real property tax assessments effective March 1, 1989.¹ The new valuations of real property are to remain in effect until the next scheduled general reassessment to be completed by March 1, 1997.² As taxpayers litigate matters related to the general reassessment and other state and local tax issues, such cases will find their way to the Indiana Tax Court. Because of the ever growing importance of the Indiana Tax Court to Indiana practitioners, this Article will concentrate on the significant recent decisions of that court in an attempt to capture and convey its judicial philosophy.

Since it first opened its doors in July of 1986, the Indiana Tax Court has become a key figure in the development and interpretation of Indiana tax law. Judge Thomas Fisher, who presides over the Indiana Tax Court, rendered important opinions on a wide array of state tax issues during the survey period, ranging from the availability of injunctive relief to whether the rental of video tapes is subject to sales tax.

Part Two of this Article will address the Indiana Tax Court's power to enjoin the collection of tax pending the outcome of the original tax appeal.³ As will be seen, Judge Fisher has considered each such petition with great care and has not been hesitant to enjoin the collection of

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1. IND. CODE § 6-1.1-4-4 (1988). Real property taxes from the March 1, 1989 assessments will be due in May and November of 1990.

2. *Id.* Last year's Survey contained an excellent discussion of the general reassessment. See Stroble & d'Avis, *Current Issues Affecting Indiana Tax Policy*, 22 IND. L. REV. 449, 449-67 (1989). Given last year's thorough treatment of the issue, this Article will not repeat any discussion of the reassessment.

3. See *infra* text accompanying notes 6-45.

taxes pending the outcome of the original tax appeal in appropriate cases.

Part Three will discuss some of the Indiana Tax Court's decisions involving tangible property, sales and use, income, and death taxes.⁴ A few important decisions of the Indiana Supreme Court will also be highlighted. Finally, Part Four will briefly address the apparent demise of the intangibles tax in Indiana.⁵

II. THE INDIANA TAX COURT'S INJUNCTIVE RELIEF POWERS

Under its enabling statute, the Indiana Tax Court has the power to enjoin the collection of taxes pending the original tax appeal. Specifically, Indiana Code section 33-3-5-11 provides that a taxpayer may seek to enjoin the collection of a tax pending the original tax appeal by filing a petition with the Indiana Tax Court.⁶ The petition must set forth a summary of (1) the issues the taxpayer will raise in the original tax appeal, and (2) the equitable considerations upon which the collection should be enjoined.⁷ After holding a hearing on the petition, the Indiana Tax Court may enjoin the collection of the tax pending the original tax appeal if the court finds that:

- (1) the issues raised by the original tax appeal are substantial;
- (2) the petitioner has a reasonable opportunity to prevail in the original tax appeal; and
- (3) the equitable considerations favoring the enjoining of the collection of the tax outweigh the state's interests in collecting the tax pending the original tax appeal.⁸

During its three years in existence, the Indiana Tax Court has interpreted this statute some eleven times in deciding whether to grant or deny the petitions for injunctive relief. A rough scorecard for the injunction cases shows that the Indiana Tax Court has granted injunctive relief seven times,⁹ while it has denied such relief on four occasions.¹⁰

4. See *infra* text accompanying notes 46-87.

5. See *infra* text accompanying notes 88-91.

6. IND. CODE § 33-3-5-11(b) (1988). The 1987 and 1988 Surveys highlighted the Indiana Tax Court's injunctive relief powers. See Dlouhy & King, *Significant Developments in Indiana Taxation*, 21 IND. L. REV. 383, 395-98 (1988); King, *Some Very Significant Developments in Indiana Taxation*, 20 IND. L. REV. 361, 374-76 (1987). This Article will explore this important subject in more detail based on recent decisions.

7. IND. CODE § 33-3-5-11(b) (1988).

8. IND. CODE § 33-3-5-11(c) (1988).

9. See *Keller v. Indiana Dep't of Revenue*, 530 N.E.2d 787 (Ind. Tax Ct. 1988); *Perkins Paving & Trucking v. Indiana Dep't of Revenue*, 513 N.E.2d 1267 (Ind. Tax Ct. 1987); *National Private Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928

One of the most recent decisions, *Keller v. Indiana Department of Revenue*,¹¹ raises a number of key issues in this setting and shows the close scrutiny which the Indiana Tax Court gives to such petitions. The *Keller* case will be analyzed at some length in order to depict the Indiana Tax Court's philosophy in this important area.

A. *The "Unclean Hands" Issue*

In *Keller*, petitioner Teresa Keller challenged the Indiana Department of State Revenue's assessments of state income taxes. Along with her original tax appeal to the Indiana Tax Court, Ms. Keller filed a petition to enjoin collection of the taxes pending the outcome of the litigation on the merits. The Department of Revenue opposed the petition for injunctive relief on the grounds that Keller had "unclean hands." The Department specifically contended that the petitioner's income, which was earned from the operation of a business called "Barbie's Rubdown," was derived from an illegal business and, therefore, should not be the subject of equitable relief. Moreover, the Department argued, the petitioner had failed to timely file her returns.¹²

Notwithstanding these arguments, which seem appealing at least on the surface, the Indiana Tax Court found that the petitioner was entitled to injunctive relief. The court first addressed the fact that Keller's income was derived from what it called a "presumed illegal business."¹³ The court noted that in order to have unclean hands, the alleged wrong "must have an 'immediate and necessary relation' to the matter before the court."¹⁴ Hence, the Indiana Tax Court wrote, "Keller's unclean hands must derive from the transaction before the court."¹⁵

In the *Keller* case, however, the Indiana Tax Court found that the petitioner's business was only incidental to the issues at hand. The

(Ind. Tax Ct. 1987); *American Trucking Ass'n v. State*, 512 N.E.2d 920 (Ind. Tax Ct. 1987); *Dunkerson v. Indiana Dep't of Revenue*, 512 N.E.2d 504 (Ind. Tax Ct. 1987); *Video Tape Exch. Co-op v. Indiana Dep't of Revenue*, 512 N.E.2d 476 (Ind. Tax Ct. 1986); and *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8908-TA-00030, 1990 WL 4890 (Ind. Tax Ct. Jan. 19, 1990).

10. See *Video Tape Exch. Co-op. v. Indiana Dep't of Revenue*, 533 N.E.2d 1302 (Ind. Tax Ct. 1988); *Keller Oil Co. v. Indiana Dep't of Revenue*, 512 N.E.2d 501 (Ind. Tax Ct. 1987); *Faris Mailing, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 480 (Ind. Tax Ct. 1987); and *R.H. Marlin, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 475 (Ind. Tax Ct. 1986).

11. 530 N.E.2d 787 (Ind. Tax Ct. 1988).

12. *Id.* at 788.

13. *Id.*

14. *Id.* (quoting *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 245 (1933)).

15. *Id.*

question before the court was whether Ms. Keller owed a certain amount of income taxes, "not the manner in which she earned her income."¹⁶ The court explained its reasoning at some length, writing:

What is material is not that the plaintiff's hands are dirty, but [whether] [s]he dirtied them in acquiring the right [s]he now asserts, or that the manner of dirtying renders inequitable the assertion of such rights against the defendant. . . . [W]e should not by this [clean hands] doctrine create a rule comparable to that by which a careless motorist would be 'able to defend the subsequent personal injury suit by proving that the pedestrian had beaten his wife before leaving his home.'¹⁷

Moreover, the *Keller* court wrote, "[a]lthough courts of equity should not condone illegal behavior, neither should they be the moral judges of matters not before them."¹⁸ The court concluded that equity does not require one seeking equitable relief to lead a blameless life. Rather, it merely requires that "she shall have acted fairly and without fraud or deceit as to the controversy in issue."¹⁹ Because no such "unclean" activity had been alleged or proven with respect to the assessment of the taxes, the Indiana Tax Court rejected this portion of the Department's unclean hands defense.²⁰

The significance of this aspect of the *Keller* decision cannot be overlooked, for as is true in the federal system, many state taxpayers who have disputes with the state taxing authorities may be tainted with histories of illegal activities or other "badges" of what some might consider improper conduct. As in *Keller*, however, it is not always the case that such alleged misconduct relates to the specific issues before the court. Yet it would be easy to simply let the petitioner's general reputation cloud the narrow issues and serve as a basis for denying that individual a full and fair opportunity to obtain injunctive relief.

In the Indiana Tax Court, however, Judge Fisher has made it clear that each petition for injunctive relief will be decided on its own merits without consideration of irrelevant factors such as reputation or allegations of misconduct, whether proven or not. Only matters that bear directly on the taxation issues at hand will be considered by the Indiana Tax Court while sitting in equity. For this, Judge Fisher should be

16. *Id.*

17. *Id.* at 789 (quoting *Republic Molding Corp. v. B.W. Photo Utils.*, 319 F.2d 347, 349 (9th Cir. 1962) (citation omitted)).

18. *Id.*

19. *Id.*

20. *Id.*

commended. His decision on this issue will no doubt be instructive for all Indiana courts.

In the second part of the unclean hands analysis in *Keller*, the Indiana Tax Court decided the narrow issue of whether a taxpayer's failure to file timely tax returns precludes a grant of equitable relief. In answering this question negatively and enjoining the collection of taxes, Judge Fisher relied heavily on the fact that although Ms. Keller had not originally timely filed her returns for the years at issue, she did eventually file the returns and otherwise cooperated fully with the taxing authorities.²¹

The Indiana Tax Court explained that while absolute failure to file tax returns would give a taxpayer unclean hands in this setting, the eventual filing of late returns in essence purged her wrongdoing and restored her right to seek equitable relief. Because no harm resulted to the Department of Revenue as a result of the late filing,²² the Indiana Tax Court found that the late filing of the returns did not preclude injunctive relief.

B. The Statutory Requirements of Indiana Code section 33-3-5-11(c).

1. *Substantiality of Issues and Opportunity to Prevail.*—Next, the *Keller* court specifically traced the requirements of Indiana Code section 33-3-5-11(c) to determine whether: (1) the issues raised were substantial, (2) the petitioner had a reasonable opportunity to prevail on the merits, and (3) equitable considerations favoring enjoining the tax outweighed the state's interest in prompt collection. In ruling for the petitioner, the Indiana Tax Court first held that the issues were substantial. The court noted that it has given the term "substantial issue" a wide variety of meanings, and indicated that a tax case need not have statewide impact under the statute.²³ The *Keller* court then determined that a substantial issue was raised because the Department of Revenue had based its assessment on statements of Keller's former employee and had disregarded the amount represented by Keller's tax returns. The Indiana Tax Court found that the "best information available" test used by the Department "raises questions concerning what is the best information available and to what extent the test should be given validity in a *de novo* proceeding."²⁴

21. *Id.* at 789-90.

22. *Id.* at 790. The Indiana Tax Court based this finding on the auditor's testimony that the assessment results would have been the same whether or not they had the returns before them. *Id.*

23. *Id.*

24. *Id.*

As to the petitioner's reasonable opportunity to prevail, the Indiana Tax Court similarly found that Ms. Keller met this requirement under the "best information available" test.²⁵

2. *Equitable Considerations - Irreparable Harm and Posting of Bond.*—Finally, the court found that the petitioner had also met the equitable considerations prong of the statute. Ms. Keller had testified as to a lack of assets to pay the assessed taxes, and the court implicitly rejected the Department's argument that "mere economic injury does not warrant the granting of a preliminary injunction."²⁶

In some cases, the court has also considered whether irreparable harm would ensue if the tax had to be paid.²⁷ As in *Keller*, however, the irreparable harm component seems to now be part of the statutory "equitable considerations" analysis of Indiana Code section 33-3-5-11(c)(3), rather than a completely separate requirement as had appeared early on.²⁸ This is demonstrated in cases such as *Perkins Paving & Trucking, Inc. v. Indiana Department of Revenue*²⁹ and *National Private Trucking Association v. Indiana Department of Revenue*,³⁰ wherein the Indiana Tax Court specifically considered the irreparable harm component as part of the equitable requirements of subdivision (c) of section 33-3-5-11. After *Keller*, irreparable harm is properly viewed as one aspect of the equitable considerations analysis.

The *Keller* court then granted the taxpayer's motion for injunctive relief and ordered her to post bond or other security in the amount of

25. *Id.*

26. *Id.* at 791. In so holding, the Indiana Tax Court in essence followed its dicta in *Faris Mailing Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 480 (Ind. Tax Ct. 1987), wherein Judge Fisher wrote that while the statement that "mere economic injury does not warrant an injunction" is correct, this is a matter of degree because "there is a point at which economic injury could become so severe that it could constitute irreparable harm." *Id.* at 482.

27. See *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8908-TA-00030 (Ind. Tax Ct. Jan. 19, 1990) (irreparable harm found where taxpayer could not raise funds to pay the tax); *Faris Mailing Inc.*, 512 N.E.2d at 482 (Ind. Tax Ct. 1987) (the court discusses irreparable harm as a separate component); *R.H. Marlin, Inc. v. Indiana Dep't of Revenue*, 512 N.E.2d 475 (Ind. Tax Ct. 1986) (irreparable harm is addressed as a separate factor).

28. The 1988 Survey authors, for instance, wrote that the early *Marlin* and *Faris* decisions indicated the court might be imposing the irreparable harm aspect as a separate fourth component; the authors even concluded, and rightfully so at that time, that counsel seeking an injunction should be prepared to argue both that their client will suffer irreparable harm *and* that all three criteria of section 33-3-5-11 are met. See *Dlouhy & King, Significant Developments in Indiana Taxation*, 21 IND. L. REV. 383, 397-98 (1988).

29. 513 N.E.2d 1267, 1269 (Ind. Tax Ct. 1987).

30. 512 N.E.2d 928, 931-33 (Ind. Tax Ct. 1987). See also *Energy Supply, Inc.*, No. 49T05-8908-TA-00030.

the tax, interest, and penalties alleged to be due.³¹ Unfortunately, however, Ms. Keller did not obtain bond or other security, and the Indiana Tax Court later dissolved her injunction.³² This is an extremely important aspect of the *Keller* case, for it now appears that the Indiana Tax Court is requiring bond or other security to be posted in nearly all of its injunctive relief cases. Yet *Keller* is the first case in which such bond was not secured. In the seven decisions in which it has granted injunctive relief, the Indiana Tax Court has required bond or other security to be posted in six of the cases.³³ In the seventh case, Judge Fisher merely ordered the taxpayer to refrain from doing anything to impair its financial position and to permit the Department of Revenue to examine its books from time to time to ensure compliance.³⁴

The issue of posting security raises two important questions. First, on what authority is the Indiana Tax Court relying to require bond? Second, what are the practical ramifications of such a requirement? As will be seen, neither question has been squarely addressed to date.

In the first case in which the Indiana Tax Court required such a bond, *Video Tape Exchange Co-op. v. Indiana Department of Revenue*, the court did not specifically state the authority for imposing such a requirement.³⁵ The court there traced the statutory injunctive relief requirements of Indiana Code section 33-3-5-11(c), and simply added the bond requirement. It must be noted that nothing in the Indiana Tax Court's injunctive relief statute addresses the issue.

In the next case in which bond was ordered, the Indiana Tax Court did give authority for requiring such security. Specifically, in *American Trucking Associations v. State*, the court explained that the equitable considerations aspect of Indiana Code section 33-3-5-11(c) "incorporates the general body of traditional equity concepts."³⁶ Thus, citing a 1982 Indiana Court of Appeals opinion, the *American Trucking* court wrote:

The basic elements to be considered when a petitioner seeks injunction relief are:

31. 530 N.E.2d at 791.

32. *Keller v. Indiana Dep't of Revenue*, No. 49T0508804-TA-00028.

33. See *Keller*, 530 N.E.2d at 791; *Perkins Paving & Trucking v. Indiana Dep't of Revenue*, 513 N.E.2d 1267, 1269 (Ind. Tax Ct. 1987); *Nat'l Private Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928, 935 (Ind. Tax Ct. 1987); *American Trucking Ass'n v. State*, 512 N.E.2d 920, 927 (Ind. Tax Ct. 1987); *Video Tape Exch. Co-op v. Indiana Dep't of Revenue*, 512 N.E.2d 478 (Ind. Tax Ct. 1987); *Energy Supply, Inc. v. Indiana Dep't of Revenue*, No. 49T05-8909-TA-00030 (Ind. Tax Ct. Jan. 19, 1990).

34. See *Dunkerson v. Indiana Dep't of Revenue*, 512 N.E.2d 504, 505 (Ind. Tax Ct. 1987).

35. 512 N.E.2d at 478.

36. 512 N.E.2d at 923.

- (1) that the petitioner will suffer irreparable harm if relief is not granted;
- (2) that the harm to the petitioner if relief is denied outweighs the harm to the respondent if relief is granted;
- (3) that the public interest will not be harmed if relief is granted;
- (4) *that petitioner will post sufficient security to cover costs and damages which the respondent may suffer if it is wrongfully enjoined.*³⁷

Thus, the Indiana Tax Court has relied on the pre-Indiana Tax Court case of *Wells v. Auberry* for the security requirement in injunctive relief cases. A review of the *Wells* case, however, does not indicate the authority upon which the Indiana Court of Appeals was relying for such a bond requirement in that case.³⁸

A further independent review of the law on injunctive relief in Indiana, however, reveals that Rule 65 of the Indiana Rules of Trial Procedure clearly states that no "preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained."³⁹ This requirement appears to be applicable to the Indiana Tax Court because Rule 1 of the Rules for the Indiana Tax Court provides that the general Indiana Rules of Trial Procedure "shall apply to actions in the Tax Court" except where the general trial rules are clearly inconsistent with the rules for the Indiana Tax Court. Because there is nothing in the Rules for the Indiana Tax Court speaking to posting of security in petitions for injunctive relief, the general provision of Trial Rule 65 should apply to the Indiana Tax Court.⁴⁰

Indeed, in an opinion issued just as this Article went to press, the Indiana Tax Court relied upon Trial Rule 65(c) in an injunctive relief case. Specifically, in *Energy Supply, Inc. v. Indiana Department of Revenue*,⁴¹ the court enjoined the Department from collecting some

37. *Id.* (emphasis added) (citing *Wells v. Auberry*, 429 N.E.2d 679, 682 (Ind. Ct. App. 1982)). The Indiana Tax Court cited the same authority in *National Trucking Ass'n v. Indiana Dep't of Revenue*, 512 N.E.2d 928, 930-31 (Ind. Tax Ct. 1987).

38. See *Wells*, 429 N.E.2d at 682.

39. IND. R. TR. P. 65.

40. A reasonable argument could be made that Trial Rule 65 does not apply because the Indiana Tax Court's injunctive relief statute does not speak to posting security. See IND. CODE § 33-3-5-11(c) (1988). Such an argument seems weak, however, given that the rules for the Indiana Tax Court require clear inconsistency for the Trial Rules not to apply. The mere failure to mention security in the Indiana Tax Court's injunctive relief statute seems to be much less than clear inconsistency.

41. No. 49T05-8908-TA-00030, slip op. (Ind. Tax Ct. Jan. 19, 1990).

\$230,000 in assessed taxes, but relied on Rule 65(c) to require that the taxpayer's refunds for other years in the amount of some \$200,000 be held by the Department "as security against any losses it could incur as a result of being wrongfully enjoined or restrained."

The Indiana Tax Court thus appears to have the authority to require the posting of security in preliminary injunction cases via Trial Rule 65. The question, then, is how the Indiana Tax Court is to determine the amount of security and how this affects the taxpayer.

Under Trial Rule 65, security shall be given "in such sum as the court deems proper, for the payment of such *costs and damages as may be incurred or suffered*" as the result of a wrongful injunction.⁴² Under well established Indiana precedent, the security required by Rule 65 is merely "intended to compensate the [respondent] for any damages incurred as a result of the preliminary injunction if [the respondent] prevails at a later hearing."⁴³ In the tax setting, such damages could arguably include the tax due, interest, and penalties thereon if the taxpayer squandered away assets during the pendency of the original tax appeal. Under this line of reasoning, it would seem that the Indiana Tax Court could require security to cover all such potential liabilities, just as it did in the *Keller* case.

In any event, it is not the purpose of this Article to fully address all possible issues relating to posting security. Rather, it is sufficient for now to merely locate the potential foundation for the requirement so that counsel can formulate their arguments accordingly. There is a substantial body of case law surrounding the security requirement of Trial Rule 65, including the general rule that the trial court has broad discretion in setting the amount of security.⁴⁴ Tax practitioners can work with such precedent to assist their clients in this aspect of obtaining injunctive relief.

A final issue concerning bond is the pragmatics of such a requirement. In *Keller*, for example, the taxpayer did not obtain bond and was thus unable to enjoin collection of the assessments. As a practical matter, it is quite likely that other individual taxpayers, unlike businesses, will be unable to post security in many instances. If this is the case, then the protections of the injunctive relief statute might be out of the reach of the taxpayers who most need its power.

This precise issue was originally raised in the *Keller* case during the taxpayer's appeal of the Indiana Tax Court's dissolution of her injunction

42. IND. R. TR. P. 65.

43. Palace Pharmacy, Inc. v. Gardner & Guidone, Inc., 164 Ind. App. 513, 515, 329 N.E.2d 642, 644 (1975).

44. See, e.g., Peters v. Davidson, Inc., 172 Ind. App. 39, 46-47, 359 N.E.2d 556, 561-62 (1977).

to the Indiana Supreme Court. The Indiana Supreme Court, however, dismissed that appeal without reaching the merits because the appellate brief failed to provide cogent argument for review.⁴⁵ Thus, it seems likely that many individual taxpayers will be hard pressed to post adequate security and thus obtain injunctive relief unless the legislature steps in to clarify this area or the Indiana Tax Court is lenient on this issue.

The *Keller* decision is thus an excellent example of how the Indiana Tax Court addresses petitions for injunctive relief. In considering the petitions, the court usually traces the requirements of Indiana Code section 33-3-5-11(c) to determine whether the statutory elements are present. In addressing the equitable considerations aspect of the statute, the court relies on general principles of injunctive relief including the requirement that security must be posted.

Because of Judge Fisher's thoroughness, counsel considering injunctive relief from the Indiana Tax Court now have a significant body of case law from which to work. Although, as *Keller* demonstrates, there are still plenty of novel issues to be addressed in the injunctive relief setting, the Indiana Tax Court has laid the basic framework from which such questions will be decided. Importantly, the *Keller* opinion indicates that the extraordinary remedy of equitable relief will not be denied to a taxpayer merely on the grounds of bad reputation. The case also demonstrates what can be gained by cooperating fully with the taxing authorities. Finally, the case raises crucial legal and philosophical issues concerning whether security must be posted by a taxpayer seeking injunctive relief. It is, perhaps, this security question that will ultimately bring the most attention to the *Keller* case.

III. SUBSTANTIVE DECISIONS

A. Sales and Use Taxes

In two similar cases the Indiana Tax Court addressed a question of first impression in Indiana of whether a club is liable for the Indiana gross retail tax (the sales tax) on a gratuity service charge added to a club member's food and beverage charges. In *Summit Club, Inc. v. Indiana Department of Revenue*⁴⁶ and *Bloomington Country Club v. State*,⁴⁷ the Indiana Tax Court held that, under each club's specific arrangement, the club was not liable for sales tax on the 15% service charges added to the patron's bill.⁴⁸

45. *Keller v. State*, 549 N.E.2d 372 (Ind. 1990) (appeal dismissed for failure to comply with Appellate Rule 8.3(A)(7)).

46. 528 N.E.2d 129 (Ind. Tax Ct. 1988).

47. 543 N.E.2d 1 (Ind. Tax Ct. 1989).

48. *Summit Club*, 528 N.E.2d at 132; *Bloomington Country Club*, 543 N.E.2d at 3.

The disputes arose under the language of Indiana Code section 6-2.5-4-1(e), which provides for the imposition of a sales tax on the gross retail income received from selling at retail, but only to the extent that the income represents:

- (1) the price of the property transferred, without the rendition of any service; and
- (2) . . . any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer, and which are separately stated on the transferor's records.⁴⁹

In both cases the Indiana Department of State Revenue had assessed the Indiana gross retail income on the grounds that the 15% gratuity service was a "bona fide" charge made for the delivery of food.

In both cases, however, the Indiana Tax Court found for the taxpayers. In *Summit Club*, the court explained that within a public restaurant the "gratuity in question . . . would either be not left at all, left in cash on the table, or added by the customer on a credit card slip."⁵⁰ Thus, the Indiana Tax Court reasoned, in a public restaurant no sales tax would be imposed on the amount. The court found that "the 15% gratuity service charge in the case at bar is in lieu of the above methods of paying the gratuity."⁵¹

The decisions in *Summit Club* and *Bloomington Country Club* thus illustrate that the Indiana Tax Court will, in cases such as these, look to substance over form. Tax counsel should be careful, however, in structuring gratuity payments in this fashion. In each case the Indiana Tax Court focused on the particular facts presented. Given that the language of Indiana Code section 6-2.5-4-1(e) would, on its face, appear to apply to such service charges, it is possible that a structure different from that in these cases could result in the imposition of sales tax on the purported gratuity charge.

For instance, in each case the Indiana Tax Court appeared to find it important that the service charge went directly to the service personnel involved. This indicates that a different result might be reached if a pooling of the charges occurred. In *Bloomington Country Club*, for

49. IND. CODE § 6-2.5-4-1(e) (1988).

50. 528 N.E.2d at 132.

51. *Id.* It should be noted that in making its decision, the Indiana Tax Court found similar cases from Illinois and Wisconsin to be persuasive. *Id.* at 131 (citing *Sangamo Club v. Department of Revenue*, 115 Ill. App. 3d 617, 450 N.E.2d 1308 (1983) and *Big Foot Country Club v. Wisconsin Dep't of Revenue*, 70 Wis. 2d 871, 235 N.W.2d 696 (1975)).

example, the court specifically wrote that "service charges are taxable when employers collect the charges and pay them out as wages or bonuses."⁵²

Thus, counsel faced with this planning issue should carefully evaluate these two opinions. Although both cases found for the taxpayer, it remains to be seen whether slightly different service charge structures might not avoid the seemingly broad language of the sales tax statute. It is at least clear that service charges paid out as bonuses or wages will be treated as part of gross retail income and will thus be taxed accordingly.

In another sales tax case, *Video Tape Exchange Co-op. v. Indiana Department of Revenue*,⁵³ the Indiana Tax Court upheld the assessment of the sales tax on the rental of videos to consumers. There the taxpayer appealed from a final determination of the Indiana Department of State Revenue assessing sales tax. In finding for the Department, the court ruled that the rental of videos is taxable, notwithstanding the language of Indiana Code section 6-2.5-4-10(c) which excludes from sales taxation the renting or leasing of an audio or video tape if the person renting the video "broadcasts the film or tape for home viewing or listening."⁵⁴ The Indiana Tax Court focused on the word "broadcast," which it found to mean more than just viewing a video at home for personal pleasure. The court explained that the word broadcast carries with it connotations of widespread dissemination to the general public.⁵⁵

On the procedural side, the *Video Tape Exchange Co-op.* court also rejected the taxpayer's argument that the Department should be estopped from assessing the tax. The taxpayer argued that it should not have to pay the tax because an employee of the taxing authority had stated over the phone that video rentals were not subject to the gross retail tax. In dismissing this contention, the court noted the rule that estoppels against the state are disfavored and will be invoked only where there is clear evidence that state agents made representations upon which the taxpayer relied. In this case the taxpayer made "only bare assertions" of the conversations and was unable to identify the nature of the conversation and the name of the employee. Moreover, the taxpayer never sought written information on the taxability of its rentals. In sum, the Indiana Tax Court found that the taxpayer had not met its burden to prove an estoppel against the state.⁵⁶

52. *Bloomington Country Club*, 543 N.E.2d at 3.

53. 533 N.E.2d 1302 (Ind. Tax Ct. 1989).

54. IND. CODE § 6-2.5-4-10(c) (1988).

55. 533 N.E.2d at 1303-04.

56. *Id.*

Finally, after rejecting what is usually a meritless argument that the Department of Revenue had selectively enforced the tax laws against the taxpayer, the *Video Tape Exchange Co-op.* court ruled that the penalties assessed against the taxpayer should be waived. The penalty was imposed pursuant to Indiana Code section 6-8.1-10-2(a), which provides:

If a person fails to file a return for any of the listed taxes or fails to pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence, or fails to timely remit any tax held in trust for the state, the person is subject to a penalty.⁵⁷

However, subsection (d) of the statute further provides that the penalty should be waived if the taxpayer shows that the failure to pay was due to reasonable cause.

In waiving the penalty, the Indiana Tax Court relied on the Department of Revenue's regulation governing reasonable cause in the penalty context. This regulation, which is found at Title 45 of the Indiana Administrative Code, section 15-11-2(c), begins by stating that the taxpayer must demonstrate "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."⁵⁸ The regulation lists a number of factors that may be considered, and states that reasonable cause "is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case."⁵⁹

In *Video Tape Exchange Co-op.*, the Indiana Tax Court found that while ignorance of the tax laws is normally not an excuse for failure to pay tax, in this case there was reasonable cause for not paying. Factors the court found persuasive included that the video industry was in its early stages, the statute was not as clear as it might be, no new regulation covered the industry, and the taxpayer had partially relied on a tax service report what indicated that rentals of video tapes were excluded from the sales tax. The court thus waived the penalty, but at the same time held that the interest on the deficiency could not be waived.⁶⁰

In the use tax area, the Indiana Tax Court ruled that the use tax was properly assessed on an airline's food purchased within Indiana and furnished to passengers and crew outside of Indiana during the course

57. IND. CODE § 6-8.1-10-2(a) (1988).

58. IND. ADMIN. CODE tit. 45, r. 15-11-2(c) (Supp. 1 1989).

59. *Video Tape Exch. Co-op.*, 533 N.E.2d at 1036.

60. *Id.*

of interstate flights. In *USAir, Inc. v. Indiana Department of Revenue*,⁶¹ the court rejected the airline's argument that the food was exempt as property purchased for resale. The court reasoned that it would strain the definition of "resale" to conclude that USAir was reselling the food to its crew and passengers when there was nothing in the price of the ticket to reflect the price of the meals. Moreover, the court ruled, the exemption from use tax for property used or consumed in providing public transportation did not apply because the service of food was not necessary and integral to the provision of transportation. Rather, the court found that such service was only incidental to the airline's transportation service.

Finally, the *USAir* court ruled that the exemption from the use tax for food sold for human consumption did not apply because of the statutory exception to that exemption whereby "take-out" or "to-go" food is taxed. In this case the court found that the food was packaged for immediate consumption and was thus not exempted from taxation.⁶²

B. Income Taxes

In affirming an earlier decision of the Indiana Tax Court, the Indiana Supreme Court held that the gross income tax applied to the sale of cheese where the buyer took delivery in state and transported the cheese in its own trucks outside the state subject to return upon out-of-state inspection. In *Associated Milk Producers v. Indiana Department of Revenue*,⁶³ the taxpayer had a facility in Warsaw, Indiana, where it produced cheese that it sold to Borden, Inc., in Ohio and Wisconsin. The cheese was loaded onto Borden trucks at Warsaw and driven to the out-of-state Borden facilities, where the cheese was inspected and tested.

The taxpayer was assessed gross income tax of some \$99,000 in relation to these sales. After paying the tax, the producer filed a claim for refund with the Department of Revenue, which was denied. The taxpayer unsuccessfully appealed to the Indiana Tax Court,⁶⁴ and then brought a direct appeal to the Indiana Supreme Court.

In affirming the Indiana Tax Court, a unanimous Indiana Supreme Court first began by noting the "onerous burden" that the taxpayer had on appeal from the Indiana Tax Court. The court wrote that it "will overturn the decision of the court below only if it was clearly erroneous," and noted that due regard shall be given to the opportunity

61. 542 N.E.2d 1033 (Ind. Tax Ct. 1989).

62. *Id.* at 1037-39.

63. 534 N.E.2d 715 (Ind. 1989).

64. 512 N.E.2d 917 (Ind. Tax Ct. 1987).

of the Tax Court to judge the credibility of the witnesses.⁶⁵ Then, in rejecting the taxpayer's Commerce Clause argument, the court found that the sale was completed in Indiana. Relying on the Department of Revenue's regulation on the issue, the court upheld the Tax Court's determination that the transactions at issue constituted a taxable out-shipment.⁶⁶ The court noted that the buyer took physical possession of the goods in Indiana and that title presumably passed to the buyer at that time pursuant to section 2-401 of the Uniform Commercial Code, absent an agreement otherwise. The Indiana Supreme Court upheld Judge Fisher's finding that the parties did not have an explicit agreement otherwise on the issue of when title passed.⁶⁷

Thus, the *Associated Milk Producers Case* shows that the mere fact that a transaction has some interstate connection does not preclude the imposition of a state tax. The case also illustrates the substantial burden a party will face in seeking to reverse the Indiana Tax Court's factual findings.

C. Tangible Property Taxes

1. *Real Property*.—In *St. Mary's Medical Center of Evansville v. State of Indiana Board of Tax Commissioners*,⁶⁸ the taxpayer appealed a final determination of the Board of Tax Commissioners denying a religious or charitable exemption from real property taxation. Indiana Code section 6-1.1-10-16 provides an exemption for all or part of a building and the land thereunder that is owned, occupied, and used for educational, literary, scientific, religious, or charitable purposes.⁶⁹ Based on this statutory provision, the Indiana Tax Court affirmed the final determination of the State Board that the taxpayer had failed to satisfy the "use and occupancy" requirements to obtain an exemption.

Specifically, the court ruled that the State Board's findings that the medical buildings were not reasonably necessary for the maintenance of the taxpayer's religious purpose were supported by substantial evidence. The taxpayer failed to meet its burden to show that the property clearly fell within the exemption statute.⁷⁰

On the procedural front, the *St. Mary's* court also rejected the taxpayer's argument that the buildings were exempt under the doctrine of legislative acquiescence. The Tax Court noted that the Indiana Supreme

65. 534 N.E.2d at 716 (citation omitted).

66. *Id.* at 717 (citing IND. ADMIN. CODE tit. 45, r. 1-1-[119] (1988)).

67. 534 N.E.2d at 717.

68. 534 N.E.2d 277 (Ind. Tax Ct. 1989).

69. IND. CODE § 6-1.1-10-16 (1988).

70. 534 N.E.2d at 278-81.

Court had cast grave doubt on this doctrine in *Indiana State Board of Tax Commissioners v. Fraternal Order of Eagles Lodge No. 255*,⁷¹ and found that the taxpayer had not shown that the Indiana General Assembly had been apprised of and acquiesced in the prior interpretation of the statute by the Board allowing the exemption. After *Eagles Lodge*, mere incorrect administrative interpretations will not invoke the doctrine of legislative acquiescence.⁷²

2. *Personal Property*.—In *Keller Industries v. State Board of Tax Commissioners*,⁷³ taxpayer Keller Industries appealed a final determination of the Indiana State Board of Tax Commissioners, which determination had denied an interstate commerce exception from personal property taxation under Indiana Code section 6-1.1-10-30(b). This statutory provision allows an exemption for personal property that has been ordered for out-of-state shipment to a specific known destination, has been placed in an original package in a warehouse for the purpose of out-of state shipment, remains in the warehouse until shipment, and is actually shipped to that specific known out-of-state destination.⁷⁴

Keller Industries was a Florida corporation that manufactured outdoor furniture in Indiana. The company took orders from customers and matched actual production with existing purchase orders such that every bill of lading corresponded to a purchase order. The Indiana Tax Court found that this arrangement satisfied the requirements of the exemption statute and thus reversed the State Board of Tax Commissioners' decision as arbitrary and capricious.⁷⁵

In *Thomas Dodge v. State Board of Tax Commissioners*,⁷⁶ the taxpayer was an Indiana automobile dealership which, in February of 1987, sold 186 new cars to an Illinois new car dealer. On March 1, 1987, the taxpayer thus had reduced its inventory to only eleven vehicles; later in March the taxpayer rebuilt its inventory to 150 vehicles. Based on these facts the Indiana State Board of Tax Commissioners found that the only possible purpose of the February sale was to avoid payment of the Indiana personal property tax, which is assessed on March 1 of each year. The State Board of Tax Commissioners assessed personal property taxation against the dealership under the language of Indiana Code section 6-1.1-3-16, which states:

If, from the evidence before him, a township assessor determines that a person has temporarily converted any part of his personal

71. 521 N.E.2d 678 (Ind. 1988).

72. *St. Mary's Medical Center*, 534 N.E.2d at 281-82.

73. 529 N.E.2d 1221 (Ind. Tax Ct. 1988).

74. IND. CODE § 6-1.1-10-30(b) (1988).

75. *Keller Industries*, 529 N.E.2d at 1224.

76. 542 N.E.2d 245 (Ind. Tax Ct. 1989).

property into property which is not taxable under this article to avoid the payment of taxes on the converted property, the township assessor shall assess the converted property to the taxpayer.⁷⁷

The taxpayer thereafter appealed the Board's final determination to the Indiana Tax Court, which ruled in favor of the taxpayer.

In reversing the State Board of Tax Commissioners and finding for the taxpayer, the *Thomas Dodge* court held that no "temporary" conversion of personal property had occurred as found by the State Board. Rather, the evidence showed that the dealer entered into a *bona fide* sale of its 186 new vehicles to an out-of-state dealer. The Indiana Tax Court noted the maxim that "[m]ere tax avoidance is not tax evasion."⁷⁸ Rather, the court wrote, "[a] taxpayer has the right to minimize or avoid taxes by any means which the law permits."⁷⁹

The *Thomas Dodge* decision is thus an excellent example of the type of activity that a taxpayer can legally engage in to minimize taxation.

D. Estate Tax

The most important decision on Indiana estate and death taxes came from the Indiana Supreme Court in *State Department of Revenue v. Estate of Eberbach*.⁸⁰ In *Eberbach* the estate, on its federal estate tax return, claimed a federal credit for state death taxes of \$2,085. The estate then filed an Indiana inheritance tax return with the trial court, which court determined that the estate owed \$2,085, the same amount the estate had claimed as a state credit on its federal return. The trial court gave the estate a 5% reduction for early payment (equating to \$104), and the estate thus paid approximately \$1,981 in Indiana inheritance tax.⁸¹

A few months later the Indiana Department of Revenue determined that the estate owed some \$3,000 in Indiana estate tax. The estate paid

77. IND. CODE § 6-1.1-3-16 (1988).

78. *Thomas Dodge*, 542 N.E.2d at 246.

79. *Id.* (citing *Ogden v. Walker*, 59 Ind. 460 (1877)).

80. 535 N.E.2d 1194 (Ind. 1989). The Indiana Tax Court addressed two cases involving death taxes during the survey period; however, these decisions are not that significant in terms of Indiana taxation and are merely noted here. See *Estate of Sowers v. Indiana Dep't of Revenue*, 533 N.E.2d 1306 (Ind. Tax Ct. 1989) (court interprets trust language of "per stirpes among my living children and grandchildren" as requiring distribution in equal shares to the decedent's three living children and only to the grandchildren by representation); *Blood v. Poindexter*, 534 N.E.2d 768 (Ind. Tax Ct. 1989) (transfer of beneficial interest in charitable remainder unitrust, including as asset a beneficial interest in land trust holding Indiana real property, to be transfer of intangible property not subject to inheritance tax).

81. *Eberbach*, 535 N.E.2d at 1195.

the assessment, sought a refund from the Department of Revenue, but the claim for refund was denied. The estate then timely appealed the Department of Revenue's final determination to the Indiana Tax Court, which held that the estate owed only \$104 in Indiana estate tax. The Indiana Tax Court ruled that the estate was liable for this amount because it was the difference between the federal credit taken for state death taxes and the actual amount of death taxes paid.⁸²

The Department of Revenue appealed the Indiana Tax Court's decision to the Indiana Supreme Court, which affirmed the Indiana Tax Court's holding. The Indiana Supreme Court explained that the Indiana *estate* tax is only imposed if the total state *death* taxes paid (which death taxes by definition include an inheritance or other transfer tax imposed because of death but do *not* include the Indiana estate tax)⁸³ are less than the maximum federal estate tax. By statute, the Indiana estate tax thus equals the remainder of (1) the federal death tax credit allowed against the federal estate tax, minus (2) the total state death taxes actually paid.⁸⁴

In this case, then, the Indiana estate tax equalled the credit allowed for death taxes, which was \$2,085, minus the total state death taxes actually paid, which was \$1,981. By applying the statute, then the total Indiana estate tax was just \$104, not the \$3,000 that the Department of Revenue assessed. The Department of Revenue had based its higher assessment of the Indiana estate tax on the *maximum* federal credit that the estate could have taken on its federal return for state death taxes, which maximum credit was some \$5,000. The Department had thus subtracted the approximately \$2,000 in state death taxes paid from the maximum federal credit for state death taxes to arrive at its \$3,000 figure.⁸⁵

The Indiana Supreme Court, however, followed the reasoning of the Indiana Tax court that the language "federal death tax credit allowed" of the Indiana estate tax statute means the amount of federal credit for state death taxes actually taken on the federal estate return, and not the amount of credit that could have been taken. In so holding, the court reasoned that the purpose of the Indiana estate tax is merely to pick up revenue that otherwise would go into the federal treasury. The court expressly stated that the "purpose of the Indiana estate tax is not furthered by allowing the Department to calculate the estate tax without regard to the actual credit taken."⁸⁶

82. See *Estate of Eberbach v. Indiana Dep't of Revenue*, 512 N.E.2d 902 (Ind. Tax Ct. 1987).

83. IND. CODE § 6-4.1-1-12 (1988).

84. *Id.*

85. *Eberbach*, 535 N.E.2d at 1196.

86. *Id.* at 1197.

The *Eberbach* estate tax decision, much like the *Thomas Dodge* personal property tax opinion, is thus another example of the maxim that taxpayers can legally attempt to reduce their tax liabilities. As the *Eberbach* court stated in quoting from one of Judge Learned Hand's most famous passages, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."⁸⁷

IV. THE DEMISE OF THE INTANGIBLES TAX

Indiana Code section 6-5.1-1-1, *et seq.*, formerly provided for the imposition of a tax on the transfer of or receipt of income from an intangible such as a promissory note, bond, contract, or other similar instrument.⁸⁸ The tax, which had been scheduled by statute to gradually phase out by the year 1996,⁸⁹ had historically raised millions of dollars in revenue for the state. During the survey period, however, the intangibles tax fell to the Constitution, the courts, and the legislature.

The first attack came from the Marion County Superior Court, which declared the intangibles tax unconstitutional in *Felix v. Indiana Department of Revenue*.⁹⁰ In *Felix*, the plaintiffs brought a class action suit challenging the constitutionality of the intangibles tax under the Commerce Clause. In striking down the tax, the court ruled that the statute impermissibly discriminates against non-Indiana corporations and their stockholders by exempting intangibles issued by Indiana entities from the intangibles tax. Moreover, the court ruled, the tax violates article ten, section one of the Indiana Constitution because the tax is in essence a property tax as it is based on a year-end valuation regardless of whether the taxpayer engaged in any transactions during the year. Because ownership of stock in foreign corporations was taxed at the intangibles rate, while stock in Indiana corporations was not taxed at all, the intangibles tax set unequal rates of property assessment in violation of the Indiana Constitution.

After much debate by the Department of Revenue and Governor Evan Bayh's administration, it was finally concluded that the case would be appealed. The case is before the Indiana Supreme Court awaiting decision.⁹¹

Effective November 10, 1988, the General Assembly repealed the intangibles tax completely. However, it remains to be seen whether the

87. *Id.* (quoting *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934)).

88. IND. CODE ANN. § 6-5.1-1-1 (Burns Supp. 1989).

89. IND. CODE § 6-5.1-2-2 (1988).

90. No. S186-0406, slip op. (Marion Sup. Ct. Nov. 10, 1988).

91. Indiana Dep't of Revenue v. Felix, No. 49500-8905-60-388 (consolidated appeal).

intangibles tax might be reintroduced if the Indiana Supreme Court finds the tax to be constitutional.

ADDENDUM

As this Article went to press, the Indiana General Assembly passed a bill that would clarify the jurisdictional questions concerning death taxes in Indiana. Specifically, Indiana Senate Bill Number 318 proposes that when an appeal from the Department of Revenue's denial of a claim for refund of Indiana inheritance or estate taxes is pursued, it must be lodged with the local probate courts having jurisdiction over the decedent's estate. Any further appeal of the tax matter would then go to the Indiana Tax Court.

This proposal, if signed into law by Governor Bayh, would clear up the statutory conflicts over jurisdiction of such cases that came about with the creation of the Indiana Tax Court.⁹² If enacted, tax practitioners should scrutinize the statute and ensure that death tax issues are presented to the appropriate tribunal.

92. See *Blood v. Poindexter*, 524 N.E.2d 824 (Ind. Tax Ct. 1988) (discussing statutory conflict and concluding that Tax Court had exclusive jurisdiction over death tax cases).

Indiana's New Financial Institutions Tax: An Extension of State Taxing Power Over Interstate Financial Transactions

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I. INTRODUCTION

A new Indiana net income tax—the financial institutions tax (“FIT”—became effective on January 1, 1990.¹ The FIT will significantly alter Indiana’s taxation of financial institutions. The legislative purpose behind the FIT was apparently twofold: (1) to modernize and standardize the taxation of domestic Indiana financial institutions and (2) to extend Indiana’s tax jurisdiction to banks and other financial institutions that realize income from Indiana sources but are not subject to Indiana’s existing taxes on banks.²

The FIT will require corporations with Indiana contacts (including many non-banks) to pay taxes to the state for the first time. Moreover, separate amendments to Indiana’s generally applicable net income tax, if read literally, could result in a dramatic expansion of Indiana’s taxing jurisdiction over nonresidents that extend credit to Indiana customers or make loans secured by Indiana property.

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1. Financial Institutions Tax, Pub. L. No. 347-1989, enacted as House Enrolled Act No. 1625 [hereinafter “HEA 1625”]. Section 1 of HEA 1625 provided for the addition of a new Article 5.5 to Title 6 of the Indiana Code. Titled “Taxation of Financial Institutions,” the new chapter, codified at IND. CODE ANN. §§ 6-5.5-1-1 to -9 (Burns Supp. 1989), provides a detailed tax scheme applicable to “financial institutions.” For taxpayers having fiscal, rather than calendar years, the financial institutions tax is effective for the first fiscal year beginning after December 31, 1989. HEA 1625, § 27.

2. Indiana’s bank tax, IND. CODE §§ 6-5-10-1 to -16 (1988), and its savings and loan association tax, IND. CODE §§ 6-5-11-1 to -11 (1988), are flat rate taxes imposed on the value of the taxpayer’s shares and/or deposits. Banks and savings and loan associations were also subject to the Indiana gross income tax, a gross receipts tax imposed on corporations. IND. CODE §§ 6-2.1-1-1 to -18 (1988). State chartered banks and savings and loans paid gross income tax and claimed it as a credit against the bank tax and the savings and loan association tax. IND. CODE §§ 6-5-10-7(b), -11-3 (1988). National banks paid the bank tax and claimed it as a credit against the gross income tax. IND. CODE § 6-2.1-4.5-1 (1988). Banks and savings and loan associations were also subject to the supplemental net income tax, an apportioned net income tax imposed on corporations. IND. CODE §§ 6-3-8-1 to -6 (1988).

II. LEGISLATIVE HISTORY

Indiana's savings and loan companies provided the initial impetus for the change in bank taxation from a gross receipts tax/capital stock tax model to a net income tax model. In prior years, the Indiana Savings and Loan League supported unsuccessful bills that would have substituted a net income tax for the existing tax/capital stock tax. Based on testimony by representatives of the savings and loan industry, a study commission of the Indiana General Assembly concluded, in 1987, that the existing structure of financial institution taxation probably needed revision in light of changes in the financial industry.³

In August, 1988, as part of the preparation of a net income tax proposal for the 1989 General Assembly, the Indiana Savings and Loan League, the Indiana Bankers Association, and the Indiana Credit Union League heard a presentation by Sandra McCray, former counsel to the Multistate Tax Commission and an author of articles on the taxation of financial institutions.⁴ In her presentation,⁵ McCray stressed the changes in the banking industry that had occurred since the enactment of Indiana's banking taxes,⁶ and argued that significant amounts of income escaped Indiana taxation under the existing tax scheme. Ms. McCray described a "state of the art" method for taxing financial institutions which would adopt a "dual approach." The dual approach would tax all income from resident taxpayers (with credits for taxes paid to other states) and would apportion the income of nonresidents over which Indiana has tax jurisdiction.⁷

Following that meeting, Patrick J. Kiely, Chairman of the House Ways and Means Committee, requested that the Legislative Services Agency and interested parties prepare a draft bill for a new financial institutions tax.⁸ A report prepared by the Agency in October, 1988, in conjunction with the proposed draft,⁹ announced an intention that the

3. Michael Landwehr, Legislative Services Agency, Memorandum to Members of the Commission of State Tax and Financing Policy (October 21, 1988) [hereinafter LSA Report]; and *State S&L League Pushes for New Tax Law*, Indianapolis Bus. J., June 22-28, 1987, at 4.

4. See McCray, *Constitutional Issues in State Income Taxes: Financial Institutions*, 51 ALBANY L. REV. 895 (1987) [hereinafter Constitutional Issues]; and McCray, *State Taxation of Interstate Banking*, 21 GA. L. REV. 283 (1986) [hereinafter State Taxation].

5. This meeting is described in the LSA Report, *supra* note 3.

6. The bank tax was enacted in 1933, 1933 Ind. Acts 544-54. The savings and loan association tax was enacted in 1939, 1939 Ind. Acts 735-36.

7. The so-called "dual approach" was also used in computing the taxable income of unitary groups. See *infra* notes 157-60 and accompanying text.

8. LSA Report, *supra* note 3, at 3.

9. *Id.*

new tax be "neutral and fair,¹⁰ competitive,¹¹ and exportable."¹² The report noted that only Minnesota had a comparable tax.¹³

The proposal was discussed on October 27, 1988, at a meeting of the Commission on State Tax and Financing Policy, a legislative study group.¹⁴ Subsequently, a bill was prepared and introduced in the General Assembly as House Bill 1625.¹⁵ House Bill 1625 was ultimately approved by the General Assembly with relatively few alterations of any substance.¹⁶

III. STATUTORY OUTLINE OF THE FIT

A. General Description

The FIT refers to itself as a franchise tax¹⁷ on the privilege of transacting business in Indiana imposed at a rate of 8.5% on the adjusted

10. In other words, "all competing businesses should have approximately the same tax burden . . ." *Id.* at 2.

11. Presumably, Indiana financial institutions should not be taxed more heavily than those of other states.

12. Nonresident institutions should be taxed on the maximum amount of income apportionable to Indiana consistent with the United States Constitution. LSA Report, *supra* note 3, at 3-4.

13. In 1987, Minnesota substantially amended its corporate franchise tax, adopting a broad nexus position. Many financial institutions that were previously beyond Minnesota's taxing power became Minnesota taxpayers. For a description of the Minnesota tax, see Jagiela & Culhane, *A Taxing Situation for Out-of-State Financial Institutions: Minnesota Sets the Stage by Adopting MTC Proposed Regulations*, 8 J. ST. TAX'N 35, 52-56 (1989). The drafters of the Minnesota tax also relied on recommendations from Sandra McCray. Corrigan, *MTC Annual Meeting Highlights: Recent Developments in State Taxation of Interstate Bank Income*, 1987 MULTISTATE TAX COMM'N REV., Sept., 1989, at 14. Both the Minnesota tax and the Indiana tax are based in large part on proposed regulations of the Multistate Tax Commission. See *Proposed Regulation for the Attribution of Income of Financial Institutions*, 1989 MULTISTATE TAX COMM'N REV., Mar. 1989, at 17 [hereinafter *Proposed Regulation*]. Despite substantial overlap, the Indiana FIT, the Minnesota tax, and the Multistate Tax Commission regulations also diverge at several points. The overlap as well as the differences make the Minnesota tax and the Multistate Tax Commission regulations useful aids in interpreting the FIT.

14. *Commission To Tackle Proposed Changes in S&L Taxes*, Indianapolis Star, Oct. 27, 1988, at ____; and *Financial Institutions Tax Reform Should Be Topic of '88 Assembly*, Indianapolis Bus. J., November 21-27, 1988, at 6A col. 1.

15. The co-sponsors of House Bill 1625 were Representatives Kiely and Bauer.

16. Although there were several changes in the bill as introduced, the major changes were the determination of a tax rate of 8.5% and the allowance of a credit for nonresidents.

17. The "franchise tax" designation may represent an attempt to qualify the FIT under 31 U.S.C. § 3124, which permits imposition of a nondiscriminatory franchise tax on interest from United States obligations. The FIT is nondiscriminatory in the sense that it includes interest from state and municipal obligations in the tax base. IND. CODE ANN. § 6-5.5-1-2(a)(8) (Burns Supp. 1989).

or apportioned income of "taxpayers."¹⁸ Nexus rules establish who is subject to the FIT and provide safe harbors for certain transactions that will not establish nexus.¹⁹ The income of a nonresident taxpayer is apportioned among Indiana and other states based on a single receipts factor.²⁰ The total income of a resident taxpayer is subject to the tax,²¹ however, a credit is provided for certain taxes paid to other states.²² A taxpayer subject to the FIT is exempt from Indiana's gross income, adjusted gross income, supplemental net income taxes and banking taxes.²³

Although, as discussed below, there are a number of ambiguous and confusing provisions in the FIT, the general statutory pattern fits its announced objectives. It places financial institutions under a comprehensive and uniform tax scheme imposed at a common tax rate. In addition, it adopts very aggressive nexus and apportionment standards which extend the taxation of interstate financial transactions to constitutional limits and possibly beyond.

B. *Taxpayers*

The financial institutions tax is imposed on a broad category of persons identified as "taxpayers,"²⁴ which the act expands far beyond traditional banking institutions. A "taxpayer" is defined as "a corporation that is transacting the business of a financial institution in Indiana."²⁵ Thus, the statutory definition of "taxpayer" contains three distinct elements: (1) a *corporate entity* requirement (it must be a corporation); (2) a *type of business* requirement (it must be engaged in the business of a financial institution); and (3) a *nexus* requirement (it must be transacting business within Indiana). Below is a flowchart illustrating the determinations that must be made to conclude whether a person is, or is not, a "taxpayer."

18. *Id.* § 6-5.5-2-1.

19. *Id.* §§ 6-5.5-3-1 to -8.

20. *Id.* § 6-5.5-2-3.

21. *Id.* § 6-5.5-2-2.

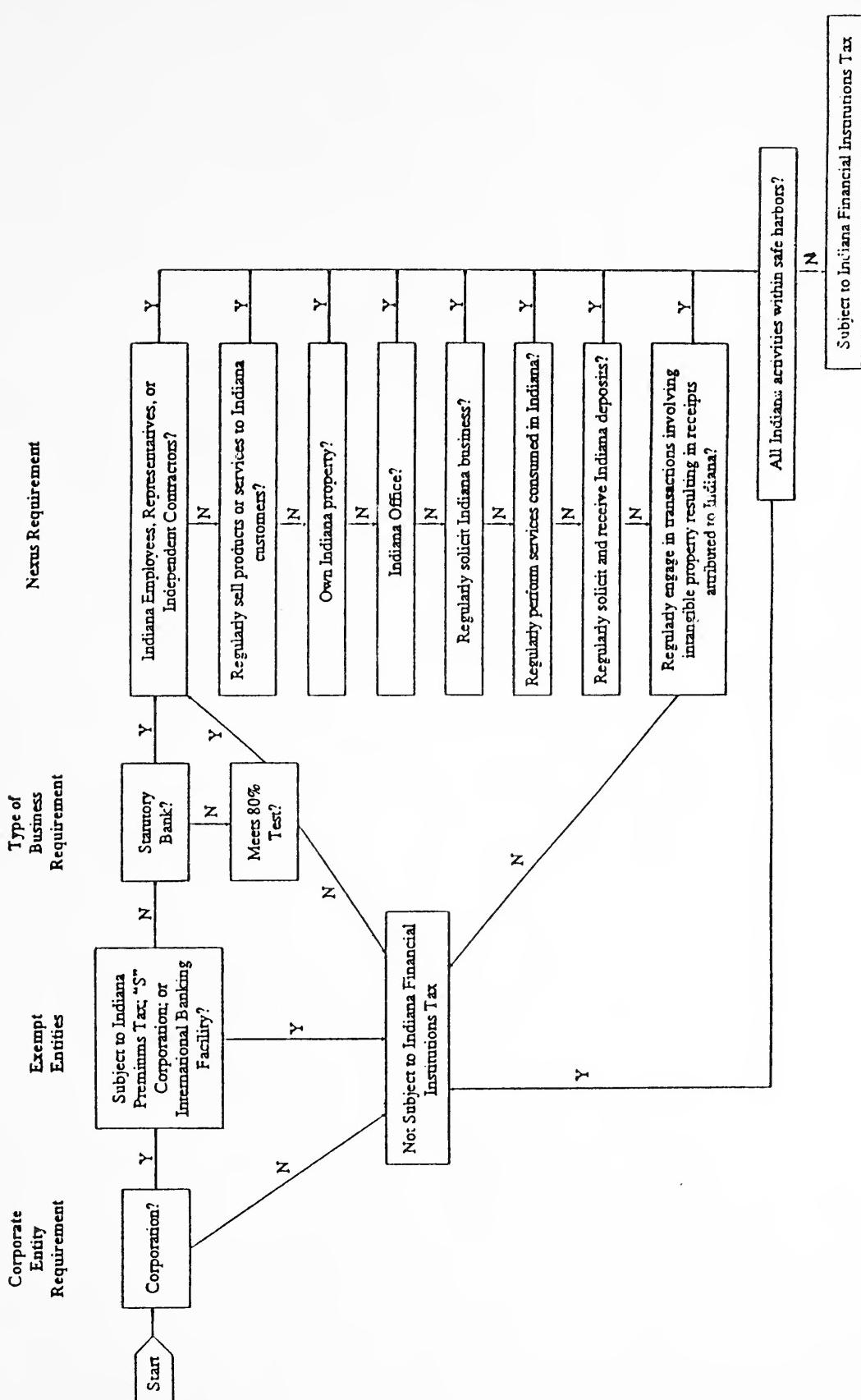
22. *Id.* § 6-5.5-2-5.

23. *Id.* § 6-5.5-9-4.

24. *Id.* § 6-5.5-2-1.

25. *Id.* § 6-5.5-1-17(a).

**Flowchart for Determining "Taxpayer" Status
under the Financial Institutions Tax**



1. *Corporate Entity Requirement.*—The FIT incorporates the Internal Revenue Code's definition of a "corporation"²⁶ and includes foreign as well as domestic corporations.²⁷

2. *Type of Business Requirement.*—The type of business requirement is automatically satisfied by certain entities that are formally organized as financial institutions (the "organizational test"). The FIT identifies four categories of corporations that meet this organizational test.²⁸ The first category is "holding companies," defined as corporations registered under the Federal Bank Holding Company Act of 1956 or registered as a savings and loan holding company (other than a diversified savings and loan holding company).²⁹ The second category is "regulated financial corporations," which includes institutions whose deposits are insured by FDIC, FSLIC, or NCUA; members of the Federal Home Loan Bank; other banks engaged in the business of receiving deposits; Indiana credit unions; production credit unions; Edge Act corporations; and agencies, branches, and subsidiaries of foreign banks.³⁰ Third, a subsidiary of a holding company or a regulated financial corporation also meets the organizational test, apparently, without regard to the nature of its actual business.³¹ Fourth, any foreign or domestic corporation meets the organizational test if it carries out the type of business activities that a holding company, regulated financial corporation, foreign bank, or a subsidiary of such an entity is authorized to perform.³²

If a corporation does not fit into one of these four specific categories, it may still be subject to the tax if 80% or more of its gross income is derived from lending and credit extension activities (the "income percentage test").³³ These activities include making, acquiring, selling, or servicing loans or extensions of credit;³⁴ leasing property in transactions that are the economic equivalent of extending credit;³⁵ and operating a credit card business.³⁶ Under the percentage test, a corporation must determine the percentage of its gross income that is attributable to the

26. See I.R.C. § 7701(a)(3) (1982).

27. IND. CODE ANN. § 6-5.5-1-6 (Burns Supp. 1989).

28. *Id.* § 6-5.5-1-17(a).

29. *Id.* § 6-5.5-1-17(b).

30. *Id.* § 6-5.5-1-17(c).

31. *Id.* § 6-5.5-1-17(a)(3).

32. *Id.* §§ 6-5.5-1-17(a)(4), (d).

33. *Id.* §§ 6-5.5-1-17(a)(4), (d)(2).

34. *Id.* § 6-5.5-1-17(d)(2)(A).

35. *Id.* § 6-5.5-1-17(d)(2)(B). This section covers only leasing activity that is the economic equivalent of the extension of credit under the Federal Reserve Board's regulations at 12 C.F.R. 225.25(b)(5). These regulations set forth nonbanking activities in which a regulated bank or its subsidiaries may engage.

36. IND. CODE ANN. § 6-5.5-1-17(d)(2)(C) (Burns Supp. 1989).

activities listed above. If the result is 80% or more, the corporation meets the business transaction requirement.³⁷

3. *Nexus Requirements.*—The statute provides a set of rules to determine when a person meets the nexus test by transacting business in Indiana³⁸ and a set of safe harbor transactions that will not establish nexus.³⁹ Under these rules, a corporation is treated as transacting business in Indiana during a taxable year if it:

- (1) maintains an office in Indiana;
- (2) has an employee, representative, or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) regularly performs services outside Indiana that are consumed within Indiana;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter [describing certain investment vehicles], and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases tangible personal or real property located in Indiana; or
- (8) regularly solicits and receives deposits from customers in Indiana.⁴⁰

Some of these activities have traditionally been recognized as creating nexus while others promise to be more controversial. For example, consistent with traditional nexus principles, the presence of employees or property in the state automatically establishes nexus. Under the FIT rules, however, regularly soliciting business from Indiana customers or regularly engaging in transactions with Indiana customers (including lending) provides nexus even though conducted *entirely* from out-of-state

37. Minnesota's comparable provision, MNN. STAT. § 290.01(4)(d) (1989), classifies a corporation as a financial institution if its income from lending activities exceeds a 50% threshold. However, the Minnesota statute also contains a provision that certain nonrepetitive extraordinary items of income will not be considered and that only those lending activities are counted which are carried on "in substantial competition" with financial institutions. The Multistate Tax Commission's proposed regulations are similar in this respect. Indiana has no comparable exclusions.

38. IND. CODE ANN. § 6-5.5-3-1 (Burns Supp. 1989).

39. *Id.* § 6-5.5-3-8.

40. *Id.* § 6-5.5-3-1.

locations.⁴¹ These latter provisions are a direct challenge to the doctrine that transactions or solicitations conducted by mail or other interstate instrumentalities are insufficient to create nexus for state tax purposes under the due process clause and the commerce clause of the United States Constitution.⁴² The continued vitality of that doctrine has been questioned recently⁴³ and is likely to be the subject of litigation soon. The nexus rules of the Indiana FIT clearly present the basic constitutional question.

The position of the drafters of the FIT seems to be that "regularly" exploiting the state's marketplace is sufficient to establish nexus, regardless of the means by which exploitation occurs. However, "regularly" is not defined by the statute, and it is not clear how many transactions are required to meet the regularity element for nexus purposes. The statute does provide that a taxpayer is "presumed, subject to rebuttal" to regularly solicit business in Indiana (1) if it conducts activities described in Indiana Code section 6-5.5-3-1(3) through (6) with twenty or more persons in Indiana in a given taxable year; or (2) if "the sum of the person's assets and the absolute value of the person's deposits attributable to Indiana" amount to \$5 million or more.⁴⁴ The FIT provides no guideline as to the proof necessary to rebut the presumption of regularity.⁴⁵

Whether assets or deposits are attributable to Indiana depends on a set of special rules.⁴⁶ Tangible assets are attributed to Indiana if located in the state. Intangible assets are attributed to Indiana if the income from those assets is attributable to Indiana under a separate set of rules. In general, income from loans to Indiana customers and loans secured by real or personal property in the state are attributable to Indiana.⁴⁷ Thus, a single loan of \$5 million to an Indiana customer or secured by

41. *Id.*

42. See *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967).

43. Cf. Pearson & Schmidt, *Why States Can Circumvent National Bellas Hess and Collect Use Taxes from Most Mail-Order Houses*, 7 J. ST. TAX'N 243 (1988); McCray, *Overturning Bellas Hess: Due Process Considerations*, 1985 B.Y.U. L. REV. 265 (1985) [hereinafter *Overturning Bellas Hess*]; *Constitutional Issues*, *supra* note 4; *State Taxation*, *supra* note 4.

44. IND. CODE ANN. § 6-5.5-3-4 (Burns Supp. 1989). The most recent draft of the Multistate Tax Commission's proposed regulations would raise the threshold of this presumption from twenty persons to one hundred. *Proposed Regulation*, *supra* note 13.

45. For a discussion of the comparable Minnesota provision, see *infra* notes 131-32 and accompanying text. The most recent draft of the Multistate Tax Commission's proposed regulation provides that the presumption can be rebutted only through "clear and convincing proof." It does not spell out the nature of such proof, however. *Proposed Regulation*, *supra* note 13.

46. IND. CODE ANN. § 6-5.5-3-5 (Burns Supp. 1989).

47. *Id.* §§ 6-5.5-4-4 to -5.

property in Indiana would create a rebuttable presumption of regular solicitation. Likewise, a bank's holding of \$5 million in deposits received from Indiana residents would also establish the presumption.⁴⁸

The FIT statute lists several safe harbor transactions, any combination of which will not be considered in determining whether a person has nexus with Indiana.⁴⁹ These safe harbors include interstate sales which are protected from state taxation by federal law,⁵⁰ the use of Indiana courts, the recording or foreclosure of mortgages or security interests in Indiana, certain securitized loan transactions (e.g. REMIC's, REIT's, and RIC's), secondary market transactions, and fiduciary services with Indiana contacts.⁵¹

C. Exempt Entities

1. *Insurance Companies.*—The FIT provides a specific exemption for insurance companies “subject to the tax under IC 27-1-18-2 or IC 6-2.1.”⁵² The reference to “IC 27-1-18-2” is to the Indiana premium tax imposed on “[e]very insurance company not organized under the laws of this state, and each domestic company electing to be taxed under this section, and doing business within this state.”⁵³ The premium tax is imposed on gross premiums received from insurance policies covering risks within the state. The reference to “IC 6-2.1” is to the gross income tax.⁵⁴ Unless an election is made to be taxed under Title 27, domestic insurance companies are subject to Indiana’s gross income tax.

The exclusion of insurance companies “subject to” the premium tax may have been intended to exclude all insurance companies, regardless of whether they actually pay the premium tax. This latter interpretation would exclude from the FIT those insurance companies having no insureds within Indiana as well as those actually paying the premium tax. However, if “subject to” is construed to mean that the insurance company must actually pay the premium tax on a current basis, a company with no

48. *Id.* § 6-5.5-3-4.

49. *Id.* § 6-5.5-3-8.

50. State Taxation of Income from Interstate Commerce, Pub. L. No. 86-272, 15 U.S.C. §§ 381-384 (1984), prohibits a state from taxing persons that do no more in the state than solicit sales and deliver products from outside the state. By its terms, P.L. 86-272 does not address the interstate sale of services. *See generally* J. HELLERSTEIN, I STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES 229-261 (1983); J. HELLERSTEIN & W. HELLERSTEIN, I STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES § 106-14 (Supp. 1988).

51. IND. CODE ANN. § 6-5.5-3-8 (Burns Supp. 1989).

52. *Id.* § 6-5.5-2-7.

53. IND. CODE § 27-1-18-2 (1988).

54. *Id.* §§ 6-2.1-1-1 to -8-10.

Indiana insurance business could be subject to the financial institutions tax as a result of its lending activities if it meets the other definitional tests for a taxpayer. Obviously, if it did not meet either the organizational test or the income percentage test, it would not be classified as a taxpayer in the first place.⁵⁵

2. *International Banking Facilities.*—International banking facilities, as defined in Regulation D of the Board of Governors of the Federal Reserve System, are also exempt from the financial institutions tax.⁵⁶ International banking facilities are banking arrangements that generally confine their depositary activities and lending to customers outside the United States.

3. *S Corporations.*—Any corporation exempt from Federal income tax under section 1363 of the Internal Revenue Code is also exempt from the FIT.⁵⁷

D. FIT Tax Base

Once a person qualifies as a taxpayer, the next step is to determine the income base subject to the tax. The statute distinguishes between residents and nonresidents in defining the tax base.

1. *Residents' Tax Base.*—A resident taxpayer is a taxpayer that transacts business in Indiana and has its commercial domicile here.⁵⁸ For resident taxpayers, the starting point is "adjusted gross income," defined as Federal taxable income under section 63 of the Internal Revenue Code, with certain special modifications (the "Indiana modifications").⁵⁹ One important modification is the addition back to the tax base of interest from state or local government obligations which would be exempt from Federal income taxation under section 103 of the Internal Revenue Code.⁶⁰ Deductions for net operating losses and

55. Consequently, an insurance company in this situation would not be subject to the FIT unless at least 80% of its gross income was derived from lending-type activities. See *supra* notes 33-37 and accompanying text.

56. IND. CODE ANN. § 6-5.5-2-7(2) (Burns Supp. 1989). Regulation D defines an international banking facility as:

[A] set of asset and liability accounts segregated on the books and records of a depository institution, United States branch or agency of a foreign bank, or an Edge or agreement corporation that includes only international banking facility time deposits and international banking facility extensions of credit.

12 C.F.R. § 204.8(a)(1) (1989).

57. IND. CODE ANN. § 6-5.5-2-7(3) (Burns Supp. 1989).

58. *Id.* § 6-5.5-1-13. See *id.* § 6-5.5-1-4 for the definition of "commercial domicile."

59. *Id.* § 6-5.5-1-2. There are special definitions for the adjusted gross income of credit unions and investment companies registered under the Investment Company Act of 1940.

60. *Id.* § 6-5.5-1-2(a)(8).

net capital losses are allowed,⁶¹ and the result is net income subject to tax. Resident taxpayers are taxed on their entire adjusted gross income without apportionment for income attributable to out-of-state sources.⁶² The tax is 8.5% of this amount.⁶³

A credit against the tax is provided to resident taxpayers to avoid double taxation. The amount of the credit is the lesser of (1) the amount of creditable taxes⁶⁴ on the resident's adjusted gross income actually paid to another state; or (2) the amount of tax that would be due at the 8.5% rate on the lesser of (a) the resident's adjusted gross income subject to tax by another state or (b) the resident's adjusted gross income that would be attributable to the other state under the attribution rules.⁶⁵

2. *Nonresidents' Tax Base.*—Nonresident taxpayers are those taxpayers that have commercial domiciles outside Indiana.⁶⁶ Federal taxable income, adjusted by the Indiana modifications, is also the starting point for computing the tax base of a nonresident taxpayer. However, that base is then narrowed to "apportioned income," which is the taxpayer's adjusted gross income apportioned to Indiana.⁶⁷ The FIT employs a single factor apportionment formula based on the attribution of the taxpayer's receipts.⁶⁸ In other words, a part of the taxpayer's total income is apportioned to Indiana based on the percentage of the taxpayer's overall receipts assigned to Indiana under special attribution rules. Non-residents are also permitted deductions for net operating losses⁶⁹ and net

61. Deductible net operating losses must (a) be allowable under the Internal Revenue Code; (b) be adjusted to reflect to the Indiana modifications required to convert Federal taxable income to Indiana adjusted gross income; (c) be incurred after 1989; and (d) be attributable to Indiana. Net operating losses may be carried forward fifteen years. *Id.* § 6-5.5-2-1(b), (c).

62. *Id.* § 6-5.5-2-2. By contrast, Minnesota provides for apportionment of both resident and nonresident taxpayers' income. *Cf.* MINN. STAT. § 290.191, subd. 1 (1988).

63. IND. CODE ANN. § 6-5.5-2-1 (Burns Supp. 1989).

64. The term "creditable tax" is defined to include a net income tax or a tax in lieu of a net income tax. *Id.* § 6-5.5-2-5(c).

65. *Id.* § 6-5.5-2-5.

66. *Id.* § 6-5.5-1-12.

67. *Id.* § 6-5.5-2-3.

68. *Id.* § 6-5.5-2-3. Both the Minnesota tax and the Multistate Tax Commission's proposed regulations employ a three-factor apportionment formula based on property, payroll, and receipts (however, Minnesota applies a 70% weighting to the receipts factor). Although a single factor approach varies from the standard three-factor apportionment formula, the United States Supreme Court upheld a single factor formula against a commerce clause challenge in *Moorman Mfg. Co. v. Blair*, 437 U.S. 267, 276-77 (1978).

69. For nonresidents, allowable net operating losses are subject to the same requirements applicable to residents. *See* IND. CODE ANN. § 6-5.5-1-2(a)(8) (Burns Supp. 1989). In addition the resulting deduction must be multiplied by the same apportionment factor used to apportion income to Indiana. *Id.* § 6-5.5-2-1(c)(1).

capital loss deductions. The resulting figure is the tax base for nonresident taxpayers.

Nonresident taxpayers are permitted a limited tax credit if receipts from a loan are attributed both to Indiana under the FIT statutes and to the taxpayer's domiciliary state under its tax laws. In addition, the original principal amount of the loan must have been \$2 million or greater.⁷⁰ The amount of the credit is the lesser of (1) the net income tax⁷¹ attributable to the loan that is actually paid to the nonresident taxpayer's domiciliary state, or (2) the amount of the financial institutions tax that is attributable to the loan.

E. Unitary Groups and Combined Returns

The FIT scheme establishes a potentially important role for the unitary method of taxation, an approach which represents a significant reversal of the state's general tax policy established only five years ago.⁷² In general, the unitary method allows separate but related corporate entities to be treated as a single taxpayer for net income tax purposes.

Because of its exclusive reliance on the unitary method, the FIT, as enacted, does not authorize consolidated tax returns.⁷³ Instead, the FIT permits the use of a combined return, a composite return that includes affiliated members which together comprise a unitary group. Although a combined return generally follows the basic concept of taxing the group members on their overall income and eliminating the effects of intercompany transactions, a combined return differs from a consolidated return in several respects.⁷⁴ In particular, a combined return is not elective and is permitted upon request (or may be imposed by the Department) only in certain circumstances:

If the department or taxpayer determines that the result of applying the other provisions of this article does not fairly represent the taxpayer's income within Indiana, the taxpayer may

70. *Id.* § 6-5.5-2-6(a).

71. A "net income tax" for purposes of the nonresident tax credit is either a direct net income tax or a franchise tax measured by net income. Unlike a "creditable tax," a net income tax does not include taxes levied in lieu of net income taxes. *Id.* § 6-5.5-2-5(c).

72. See *infra* notes 150-53 and accompanying text.

73. "Consolidated return" generally refers to a return made by a related group of entities, generally defined by federal law. *See, e.g., IND. CODE ANN. § 6-3-4-14* (Burns Supp. 1989) (permits the filing of an adjusted gross income tax consolidated return for affiliated corporations as defined in the regulations under § 1502 of the Internal Revenue Code). *See generally* Rudolph, *State Taxation of Interstate Business: The Unitary Concept and Affiliated Groups*, 25 TAX L. REV. 171, 197-98 (1970).

74. Rudolph, *supra* note 73, at 197-98.

petition for and the department may allow, or the department may require, in respect to all or a part of the taxpayer's business activity any of the following:

- (1) separate accounting.
- (2) a reallocation of tax items between a taxpayer and a member of the taxpayer's unitary group.
- (3) the filing of a combined return by each taxpayer transacting business in Indiana that is a member of a unitary group.⁷⁵

Thus, a combined report is permitted only when the provisions of the FIT do not fairly reflect a taxpayer's Indiana income. In all other cases, each individual taxpayer must file separately even though it joins in a consolidated return with affiliates for Federal income tax purposes.

Combined filing is limited to corporations that form a unitary business, defined as follows:

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a corporation, a partnership, or a trust. The term "unitary group" includes those entities that are engaged in a unitary business wholly within or within and without Indiana.⁷⁶

The tax base for a unitary business consists of (1) 100% of the adjusted gross income of resident members, and (2) that portion of the nonresident members' adjusted gross income determined by multiplying their adjusted gross income by a fraction, the numerator of which is their Indiana receipts and the denominator of which is their total receipts.⁷⁷ Dividends and other receipts from transactions among members of a unitary group are eliminated in the combined return.⁷⁸ Resident members of unitary groups are also permitted the same credit provided to non-unitary resident taxpayers for taxes paid to other states.⁷⁹

F. Attribution of Receipts

The FIT provides a detailed set of rules for attributing receipts for purposes of the single factor apportionment formula.⁸⁰ These same rules

75. IND. CODE ANN. § 6-5.5-5-1(a) (Burns Supp. 1989).

76. *Id.* § 6-5.5-1-18(a).

77. *Id.* § 6-5.5-2-4.

78. *Id.* § 6-5.5-5-2.

79. *Id.* § 6-5.5-2-5.

80. *Id.* §§ 6-5.5-4-1 to -15.

are also used for certain purposes in the determination of Indiana nexus.⁸¹ The attribution rules allocate the following receipts⁸² to Indiana:

- (1) Lease and rental receipts from real or tangible personal property located in Indiana.⁸³
- (2) Interest and other receipts from loans secured by real or tangible personal property located in Indiana.⁸⁴
- (3) Interest on installment sales contracts that deal with real or tangible personal property located in Indiana.⁸⁵
- (4) Income from unsecured consumer loans if the borrower is an Indiana resident.⁸⁶
- (5) Income from unsecured commercial loans if the loan is to be applied in Indiana, or if that cannot be determined, if the borrower applied for the loan in Indiana.⁸⁷
- (6) Fees from the issuance of letters of credit, acceptance of drafts, "and other devices for assuring or guaranteeing loans or credit" under the same principles applicable to commercial loan receipts.⁸⁸
- (7) Credit card fees, such as annual cardholder fees, and interest if these amounts are regularly billed to Indiana.⁸⁹
- (8) Receipts from the sale of an asset if income from that asset would be attributed to Indiana.⁹⁰
- (9) Receipts from the performance of fiduciary and other services if the services are consumed in Indiana, or a pro rata portion of such receipts if the benefits are consumed in more than one state.⁹¹

81. For example, under IND. CODE ANN. § 6-5.5-3-1(6) (Burns Supp. 1989), nexus is established by regular transactions involving intangible property that result in receipts to Indiana under these assigned attribution rules. *See supra* notes 46-48 and accompanying text.

82. *Id.* "Receipts" is defined as follows: "'Receipts' includes all gross income, including net taxable gain on disposition of assets such as securities and money market transactions, when derived from transactions and activities in the regular course of the taxpayer's trade or business. . . ." *Id.* § 6-5.5-4-2. Thus, receipts from the repayment of loan principal and from transactions outside the normal course of business should be excluded from the attribution formula.

83. *Id.* § 6-5.5-4-3.

84. *Id.* § 6-5.5-4-4.

85. *Id.*

86. *Id.* § 6-5.5-4-5.

87. *Id.* § 6-5.5-4-6.

88. *Id.* § 6-5.5-4-7.

89. *Id.* § 6-5.5-4-8.

90. *Id.* § 6-5.5-4-9.

91. *Id.* § 6-5.5-4-10.

(10) Receipts from securities issued by Indiana governmental entities.⁹²

A taxpayer's nonbusiness income is attributed to its commercial domicile.⁹³ Any other income "shall be attributed to Indiana in the same manner that aggregate receipts are attributed to Indiana under [the previously discussed allocation rules]."⁹⁴

The attribution rules make no exceptions for receipts falling within the nexus safe harbor provisions. For example, performance of fiduciary services is within a safe harbor for determining nexus. However, receipts from the performance of certain fiduciary services may be attributed to Indiana if nexus is determined to exist.⁹⁵ Thus, a financial institution may engage in any number of safe harbor activities without becoming subject to the FIT. However, once non-safe harbor activities are sufficient to provide Indiana tax nexus, the receipts from the safe harbor activities are used in determining the amount of the taxpayer's income apportioned to Indiana.⁹⁶ That rule could operate harshly for a taxpayer with substantial safe harbor transactions that has nexus with the state because of unrelated and relatively minor transactions falling outside the safe harbor rules.

There is nothing in the FIT statutes which grandfather existing relationships. Thus, if a taxpayer is subject to the FIT beginning in 1990, receipts from outstanding loans or other transactions entered into in earlier years will be included in determining the amount of income apportioned to Indiana.

92. *Id.* § 6-5.5-4-12.

93. *Id.* § 6-5.5-4-14.

94. *Id.* § 6-5.5-4-15. See *infra* notes 146-47 and accompanying text.

95. IND. CODE ANN. § 6-5.5-4-10 (Burns Supp. 1989).

96. This conclusion is based on the limited effect of the introductory language to the safe harbor provisions: "[A] taxpayer is not considered to be *transacting business in Indiana* if the only activities of the taxpayer in Indiana are. . ." *Id.* § 6-5.5-3-8 (emphasis added). This indicates that the safe harbors are disregarded solely in the determination of nexus. The conclusion is also supported by the inclusion of income from safe harbor activities in the chapter providing for the attribution of receipts to determine the apportionment factor. In contrast, Minnesota's statute is very clear on this point. "[I]f a financial institution is subject to tax under this chapter, its interest in [safe harbor property] is included in the receipts factor[.]" MINN. STAT. § 290.191, subd. 6(o) (1989). However, receipts from safe harbor transactions (other than interest on Minnesota state or municipal obligations) are attributed on the basis of the ratio of in-state deposits to total deposits for regulated financial institutions and the ratio of in-state gross business income to total gross business income in the case of unregulated financial institutions. Jagiela & Culhane, *supra* note 13, at 59. Indiana's FIT provides no such special attribution rules for safe harbor activities.

IV. AMENDMENT OF INDIANA'S NET INCOME TAX NEXUS RULE

In addition to the FIT, Indiana has a generally applicable net income tax, the adjusted gross income tax, which is imposed at a flat rate of 3.4% on the adjusted gross income of both individual and corporate taxpayers.⁹⁷ Another net income tax, the supplemental net income tax, is imposed on corporate taxpayers at a flat rate of 4.5%.⁹⁸ The enactment of the FIT was accompanied by certain amendments to the nexus and apportionment provisions of the adjusted gross income tax, which are incorporated by reference into the supplemental net income tax statutory scheme.⁹⁹

The adjusted gross income tax is imposed "on that part of the adjusted gross income derived from sources within the state of Indiana of every nonresident person."¹⁰⁰ Under prior law, adjusted gross income from intangible property was treated as derived from Indiana only if it had a situs in the state:

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

....

(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property *having a situs in this state.*¹⁰¹

As of January 1, 1990, subsection (a)(5) has been amended to read: "(5) Income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property *if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.*"¹⁰² A new section, section 6-3-2-2.2, attributes intangible receipts to Indiana under a set of rules similar, but not identical, to the rules used for attributing receipts in the FIT statute.¹⁰³ Taken literally, therefore, the

97. IND. CODE §§ 6-3-1-1 to 6-3-8-5 (1988).

98. *Id.* §§ 6-3-8-1 to -6.

99. *Id.* § 6-3-8-5.

100. *Id.* § 6-3-2-1(a).

101. *Id.* § 6-3-2-2(a) (*amended by* IND. CODE ANN. § 6-3-2-2 (Burns Supp. 1989) (*emphasis added*)).

102. IND. CODE § 6-3-2-2(a)(5) (as amended by HEA 1625; effective January 1, 1990) (*emphasis added*).

103. IND. CODE ANN. § 6-3-2-2.2(a) (Burns Supp. 1989). This new section does not cover receipts from sales of intangible assets, letter of credit fees, and receipts from Indiana governmental securities.

amended statute provides that Indiana will impose its adjusted gross income tax any time a nonresident has receipts from loans to Indiana customers or loans primarily secured by Indiana property. The statute contains none of the regularity requirements of the FIT and none of its safe harbors. It is not clear whether the legislature intended to extend the scope of the adjusted gross income tax even beyond the already far reaching nexus provisions of the FIT. However, the literal language of the amendment may compel that result.

Once nexus is established under the adjusted gross income tax because the taxpayer is deemed to have income derived from Indiana sources, the actual tax base is determined by use of a traditional three-factor apportionment method, which was also amended to include in the sales factor receipts from intangible property. Intangible receipts are to be assigned as provided in the new Indiana Code section 6-3-2-2.2.¹⁰⁴

V. BUSINESS ACTIVITY REPORT

The act adopting the FIT also added a requirement for an annual business activity report.¹⁰⁵ The report must be filed annually by "every corporation that carries on any business activity or owns or maintains property in Indiana."¹⁰⁶ Thus, the new reporting requirement extends to all corporations and not just to financial institutions. However, a report is not required from a corporation if: (1) it files a return for either the FIT or the adjusted gross income tax; (2) it is registered to do business in Indiana; or (3) it is exempt from taxation under the FIT or adjusted gross income tax provisions.¹⁰⁷ Until a required business activity report is filed, a corporation may not pursue claims arising under or contracts executed under Indiana law in Indiana courts.¹⁰⁸ Indiana activities which trigger the filing requirement include the maintenance of a place of business in Indiana; the presence of employees, agents, or independent contractors in Indiana if they are conducting business on behalf of the corporation; owning any property (including intangible property) located in Indiana; and any activity referred to in 6-5.5-3, the nexus provisions of the FIT.¹⁰⁹ In other words, a corporation engaging in any of the activities that will establish nexus under the FIT must file the business

104. *Id.* § 6-3-2-2(e).

105. IND. CODE § 6-8.1-6-6, added by NEA 1625, effective Jan. 1, 1990, Pub. L. No. 347-1989 § 19.

106. *Id.*

107. *Id.* § 6-8.1-6-6(b).

108. *Id.* § 6-8.1-6-6(c). However, the Indiana suit may continue if the filing omission is corrected, the reporting requirement does not apply, a tax return is filed, or security is provided sufficient to cover any taxes, interest, and penalties that may be due. *Id.*

109. *Id.* § 6-8.1-6-6(d).

activity report, even if the corporation is not subject to the FIT because it does not meet the type of business requirement.¹¹⁰

VI. REGULATIONS

The Department is authorized to issue regulations to implement the FIT.¹¹¹ To ensure that the regulations are a priority, the Indiana General Assembly required that the regulations be promulgated before January 1, 1991.¹¹² Recognizing that such regulations will not be available at the time the FIT becomes effective, the General Assembly also provided that, until the Department's regulations are effective, the regulations under section 7805(a) of the Internal Revenue Code are to be treated as applicable to the FIT.¹¹³ Although the Treasury regulations may supply some definitions, they will likely be of little value in analyzing the more difficult interpretative questions arising under the FIT.

Additionally, the General Assembly required the Department to identify those nonresidents who will either become subject to the FIT or whose liability will be changed by the amendments to the adjusted gross income tax statutes, to provide notice to those persons, to determine its needs for enforcement of these taxes, and to make periodic reports to the legislature on its progress.¹¹⁴ The annual report is to include recommended amendments to the FIT.¹¹⁵ The legislature apparently recognizes that the current form of the FIT may require corrections.

VII. DISCUSSION OF ISSUES RAISED BY THE NEW LAW

A number of uncertainties exist concerning the proper scope and application of the FIT statutes and the amendments to the adjusted gross income tax. The FIT's broad nexus provisions also raise questions about the state's power to tax persons having minimal local activities. The remainder of this Article will discuss some of these issues.

A. *The Nexus Rules*

1. *Establishing Nexus through Independent Contractors.*—A taxpayer is treated as transacting business in Indiana if it has employees,

110. As discussed below, the business activity report is required as a result of carrying on any activity described in IND. CODE § 6-5.5-3. That would appear literally to encompass even the safe harbor activities set forth in section 6-5.5-3-8 although such a result was probably not intended.

111. IND. CODE ANN. § 6-5.5-9-1 (Burns Supp. 1989).

112. HEA 1625, § 28.

113. *Id.*

114. *Id.* § 29.

115. *Id.*

representatives, or independent contractors conducting business in the state.¹¹⁶ Maintaining local employees or representatives has traditionally been recognized as conferring tax jurisdiction.¹¹⁷ Asserting nexus on the basis of hiring local independent contractors, however, raises questions. Cases finding nexus on the basis of independent contractor activities normally have involved in-state contractors soliciting on behalf of an out-of-state taxpayer or servicing customers in the state.¹¹⁸ The FIT contains no such limitation. Instead, it is sufficient that the independent contractor conduct some form of business on behalf of the taxpayer. Thus, it is arguable that an out-of-state corporation that engages the services of Indiana lawyers, accountants, investment advisors or similar professionals who carry out some business in the state on behalf of the corporation may be sufficient to establish tax nexus.¹¹⁹ Aside from the constitutional issues raised, the policy behind such a broad nexus rule is questionable.

2. *Scope of the Regular Solicitation Test for Nexus.*—Regularly soliciting business from Indiana customers establishes nexus.¹²⁰ Nothing in the statute suggests that the manner by which solicitation is carried out is relevant. Presumably, mail or telephone solicitation and local

116. IND. CODE ANN. § 6-5.5-3-1(2) (Burns Supp. 1989).

117. International Shoe Co. v. Washington, 326 U.S. 310 (1945).

118. In *Scripto v. Carson*, 362 U.S. 207 (1960), the presence of several salesmen in a state was held sufficient to require a corporation to serve as a collection agent for use tax. *Id.* at 211. The Court held that the designation of the salesmen as independent contractors was not of constitutional significance. *Id.* See also *Tyler Pipe Indus. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987) (independent contractors soliciting on behalf of a taxpayer established nexus for purposes of gross receipts taxes); *Illinois Men's Ass'n v. State Bd. of Equalization*, 34 Cal. 3d 839, 671 P.2d 349, 196 Cal. Rptr. 198 (1983), *appeal dismissed*, 466 U.S. 93 (1984) (in-state independent contractors performing insurance claim adjustment functions established nexus for purposes of insurance premium taxes); *Howell v. Rosecliff Realty*, 52 N.J. 313, 245 A.2d 318 (1968) (same).

119. See Jagiela & Culhane, *supra* note 13, at 54, for an expression of similar fears caused by substantially identical statutory language in Minnesota's financial institutions tax statute. The question that may have to be faced under this statute is whether jurisdiction is established under the Commerce Clause by activities of an in-state independent contractor that are an integral part of the taxpayer's overall business but, by themselves, "are not significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for [its] sales." Cf. *Tyler Pipe Indus. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987). Minnesota adopted language that makes it clear that the purchase of services from a Minnesota resident is not to be taken into consideration in determining whether the nonresident is subject to tax, "except for services involving either direct solicitation of Minnesota customers or relationships with Minnesota customers after sales are made." MINN. STAT. § 290.015, subd. 4(b) (1989). The participation of a Minnesota bank in a transaction involving a Minnesota borrower and a non-Minnesota financial institution is also not to be considered for this purpose. *Id.* § 290.015, subd. 4(c).

120. IND. CODE ANN. § 6-5.5-3-1(4) (Burns Supp. 1989).

advertising as well as advertising in national publications or on national television would qualify for establishing nexus.¹²¹ If applied this aggressively, the nexus provisions of the FIT appear to be directly in opposition to *National Bellas Hess, Inc. v. Department of Revenue*.¹²² Credit card companies, mortgage lenders, and other regular providers of financial services to Indiana customers will be subjected to the FIT regardless of the means by which they market their services to in-state residents.

3. *Nexus Without Solicitation*.—Regularly engaging in transactions with Indiana customers is a basis for nexus that is separate from solicitation.¹²³ Thus, it appears that nexus could be established where the transactions arose without any solicitation by the lender, as for example, when the borrower contacted the lender. It is not implausible that a large money center bank might make a sufficient number of Indiana loans to meet the regularity test without carrying on an in-state solicitation program, especially in the case of large commercial loans. The absence of any definition of "regularly" invites such conclusion, especially when coupled with the "rebuttable presumption" that twenty transactions establishes regularity.

Loans made without in-state solicitation present a less favorable factual setting for those seeking to overturn or limit *National Belles Hess*, who usually point to regular and continuous solicitation as the basis for nexus.¹²⁴ As held in *National Geographic Society v. California Board of Equalization*,¹²⁵ jurisdiction to tax requires "some definite link, some minimum connection" between the state and the taxpayer.¹²⁶ The "slightest presence" of the taxpayer in the state is not enough.¹²⁷ It remains to be seen whether regular lending activities without in-state solicitation establish the required minimum connection. At least one author has suggested that they do, especially in the case of secured loans.¹²⁸

121. By contrast, the Minnesota statute gives specific examples of advertising activities included within "solicitation." MINN. STAT. § 290.015, subd. 1(d) (1988).

122. 381 U.S. 753 (1967). See *supra* notes 42-43 and accompanying text.

123. IND. CODE ANN. § 6-5.5-3-1(6) (Burns Supp. 1989).

124. Cf. *Overturning Bellas Hess*, *supra* note 43, at 284; *State Taxation*, *supra* note 4, at 310.

125. 430 U.S. 551 (1977).

126. *Id.* at 561 (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954)).

127. *Id.* at 556.

128. FEDERAL CONSTITUTIONAL LIMITATIONS ON STATE TAXATION OF MULTISTATE BANKS, TO BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT OF A STUDY UNDER PUB. LAW NO. 91-156, STATE AND LOCAL TAXATION OF BANKS, BEFORE THE SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 91ST CONG., 1ST SESS., 453 (1971) (Hellerstein, App. 11).

4. *Regularity.*—Because the statute refers to “*transactions* with customers in Indiana,” it appears that more than one transaction in a taxable year is necessary. Thus, a single transaction by itself should fail the regularity requirement. However, that transaction could be considered along with other related or unrelated transactions in determining whether the regularity element is present.

Once the taxpayer engages in transactions with twenty persons or obtains assets (including loans) totalling \$5 million, a rebuttable presumption arises that the taxpayer is regularly soliciting business in Indiana.¹²⁹ The statute contains no guidelines concerning how to rebut the presumption when it applies.¹³⁰ It also fails to give any indication of how many transactions beyond one will support a finding of “regularity.”

The Minnesota statutes contain a similar rebuttable presumption. However, the Minnesota statute provides a safe harbor that is absent from the Indiana statute.¹³¹ A taxpayer that does not meet the twenty person/\$5 million presumption and also has no in-state place of business, employees, independent contractors, or property is not subject to the Minnesota tax.¹³² Indiana’s FIT provides no assurance that a taxpayer who avoids the rebuttable presumption is exempt. In other words, it is not clear whether engaging in less than twenty transactions can rise to the level of regularity under the FIT.

5. *The Indiana Customers Element.*—Under the broadest of the FIT’s tests for nexus, a taxpayer may become taxable if it “regularly engages in transactions with customers in Indiana.”¹³³ The statute provides no enlightenment concerning when a customer is “in Indiana.” The issue could become important when an out-of-state taxpayer has contacts with a borrower that has multistate contacts and may not be clearly identifiable as a customer “in Indiana” as opposed to some other state.

It is possible that only those customers with Indiana commercial domiciles would be treated as “in Indiana.”¹³⁴ It is also possible that the Department of Revenue would consider the taxpayer to have engaged in a transaction with a customer *in Indiana* if the decision to enter into the transaction was made by a branch office of the customer located in Indiana even if the customer had its actual commercial domicile in a different state.

129. IND. CODE ANN. § 6-5.5-3-4 (Burns Supp. 1989).

130. This is also true of the similar rebuttable presumption provided by the Minnesota tax law. Apparently, the Minnesota taxing authorities have not provided any guidance on this point either. Jagiela & Culhane, *supra* note 13, at 41.

131. MINN. STAT. ANN. § 290.015, subd. 2(a) (1988).

132. *Id.* § 290.015, subd. 1(a), 2(b).

133. IND. CODE ANN. § 6-5.5-3-1(6) (Burns Supp. 1989).

134. Commercial domicile is used to determine whether a taxpayer is a resident or a nonresident. *Id.* §§ 6-5.5-1-4, -11, -12.

Finally, the statute might be read in such a way that the customer's headquarters or branch location is basically irrelevant. Thus, if "in Indiana" is treated as modifying "engages" rather than "customer," the sole focus would be on whether the receipts from a loan were attributed to Indiana. Under that approach, if the primary security for a secured loan were located in Indiana or the proceeds of an unsecured loan were applied in Indiana, the loan would count toward establishing Indiana nexus regardless of the fact that both the lender and the customer were headquartered out of state and negotiated and closed the loan outside Indiana.

B. *Statutory Safe Harbors*

Several types of transactions with Indiana contacts are specifically excluded from consideration in determining nexus. Because of the broad reach of the nexus rules, clearly defined safe harbors are essential.

1. *Securitized Loans.*—The ownership of a securitized¹³⁵ pool of loans with Indiana collateral does not count toward the regularity requirement for nexus purposes. The Minnesota tax contains a similar safe harbor, but, inexplicably, the Indiana FIT materially narrows the exemption.¹³⁶ The result is essentially to deprive certain receivable based financings and certain other financings from the scope of the safe harbor.

2. *The Secondary Market Exception.*—Safe harbors are provided for certain income-producing intangible assets if "the payment obligations

135. The term "securitized" refers to ownership of an interest in a pass-through entity, such as a trust or partnership, that actually owns an intangible asset, which, if held outright, would subject the owner to the FIT. It has been argued that exempting "securitized" loans from nexus consideration, while including direct loans, may be subject to challenge under the Equal Protection Clause of the U.S. Constitution. See Jagiela & Culhane, *supra* note 13, at 46. Any loan can be securitized by placing it in a pass-through entity such as a trust and then distributing beneficial interests in the trust. It is questionable whether such a formality should justify the disparate treatment accorded to the owner of an outright loan secured by Indiana property and a beneficiary of a trust which owns a loan secured by Indiana property.

136. The Minnesota safe harbor, MINN. STAT. § 290.015, subd. 3(b)(3) (1988), has been modified as follows for purposes of inclusion in the Indiana FIT:

an interest in a loan-backed, *mortgage-backed*, or *receivable-backed* security representing either: (i) ownership [or participation] in a pool of promissory notes, *mortgages*, or *receivables* or certificates of interest or participation in such notes, *mortgages*, or *receivables*, or (ii) debt obligations or equity interests which [that] provide for payments in relation to payments or reasonable projections of payments on the notes [or certificates], *mortgages*, or *receivables*, and which are issued by a financial institution or by an entity substantially all of whose assets consist of promissory notes, *mortgages*, *receivables*, or interests in them.

The italicized language is included in the Minnesota statute but excluded from the Indiana statute. The language in brackets is in Indiana's statute but not it that of Minnesota.

were solicited and entered into by a person that is independent and not acting on behalf of the owner.”¹³⁷ The evident purpose of these provisions is to permit Indiana loans to be freely transferred without the purchaser being subjected to the FIT. Absent such a provision, the marketability of Indiana financial instruments might be hindered. This problem resulted in the amendment of Minnesota’s nexus statute, which originally contained no secondary market exemption.¹³⁸ Precisely what type of proof will be necessary to establish that the purchaser is independent of the originator of the obligation is presently unknown.¹³⁹

3. *Money Market Instruments and Securities.*—As noted, the Indiana FIT provides a safe harbor for secondary market transactions but not for original issue obligations which are “entered into” by the taxpayer and not by some other person. Thus, the purchase of commercial paper, corporate bonds, state or municipal obligations, and other securities issued by Indiana entities could count toward a finding of nexus if acquired in an original (rather than secondary) purchase transaction and if held as a means of furthering the purchaser’s trade or business.¹⁴⁰ Prior to 1989, Minnesota took the same approach. However, in recognition of the adverse impact on marketability, the Minnesota legislature extended its safe harbor activities to include ownership of an interest in all money market instruments or securities.¹⁴¹ This amendment was made retroactive to 1987. It remains to be seen whether the Indiana legislature will find it necessary to make a similar amendment to the FIT.

C. Apportionment Issues

The FIT provides a set of rules for attributing receipts to a given state.¹⁴² The apportionment percentage for nonresident taxpayers is derived from these allocations.

1. *Loans.*—Interest and other receipts from loans *primarily* secured by, or dealing with, real or tangible personal property are allocated to

137. IND. CODE ANN. § 6-5.5-3-8(5)(C) and (D) (Burns Supp. 1989).

138. See Jagiela & Culhane, *supra* note 13, at 52-56.

139. A proposed amendment to the identically phrased Minnesota statute would have provided objective guidelines to determine when the secondary market exemptions applied. See Jagiela & Culhane, *supra* note 13, at 57-58. This amendment was apparently not enacted.

140. IND. CODE ANN. §§ 6-5.5-3-1(6), 6-5.5-4-14 (Burns Supp. 1989).

141. MINN. STAT. § 290.015, subd. 3b(2) (1988). See *id.* § 290.191, subd. 6(c) and (d) for the definition of “money market instruments” and “securities.” These definitions are substantially identical to those in the Indiana FIT. IND. CODE ANN. § 6-5.5-4-2(2), (3) (Burns Supp. 1989).

142. IND. CODE ANN. §§ 6-5.5-4-1 to -15 (Burns Supp. 1989).

Indiana if the property is located in Indiana.¹⁴³ The allocation is apparently made on an all-or-nothing basis depending on the location of the security for the loan.

Unsecured loans are allocated on the basis of the state where the loan proceeds are "applied."¹⁴⁴ Because of the absence of the word "primarily," it is not clear whether unsecured loan receipts are assigned to Indiana even if only a small portion of the loan is applied in Indiana, whether the primary state of application controls, or whether a proportional allocation can be used.

If the lender cannot determine where the borrower applied the loan proceeds, the state where the borrower "applied for" the loan controls. The loan is deemed to be "applied for" through an "initial inquiry" or "submission of a completed loan application." This test might be workable in the context of loans made through loan production offices or branch banks. It is less practical in dealing with substantial commercial loans.¹⁴⁵

2. *Other Income*.—The allocation statute provides that other income "shall be attributed to Indiana in the same manner that aggregate receipts are attributed to Indiana under [the other attribution rules]."¹⁴⁶ It is unclear whether this provision contemplates the application of the overall percentage obtained from the prior attribution rules to other income or whether the application of *similar principles* should determine the allocation. This is an important question in light of the fact that the "other income" includes income attributable to such intangibles as shares of stock, partnership interests, beneficial interests in trusts, securities acquired in the secondary market, etc. It appears likely that the overall percentage determined for other activities under the specific attribution rules is to be used to assign receipts falling into the catch-all clause.¹⁴⁷

3. *Consumption of Services*.—Receipts from the performance of fiduciary and other services are attributed to Indiana if the benefits of

143. *Id.* § 6-5.5-4-4.

144. *Id.* § 6-5.5-4-6.

145. Minnesota assigns the receipts to the "state in which the office of the borrower from which the application would be made in the regular course of business is located." (If that cannot be determined, the transaction is excluded from the apportionment formula). MINN. STAT. § 290.191, subd. 6(h) (1988). The Multistate Tax Commission's proposed regulations always assign the receipts to the state of the borrower's residency. *Proposed Regulation*, *supra* note 13.

146. IND. CODE ANN. § 6-5.5-4-15 (Burns Supp. 1989).

147. In this connection, Minnesota provides that receipts from securities and money market instruments are attributed based on the overall percentages derived for deposits in the case of financial institutions and based on the overall percentage of gross business income in the case of unregulated financial institutions. MINN. STAT. § 290.191, subd. 7 (1988).

the services are consumed in Indiana.¹⁴⁸ In some cases, this rule will be easy to apply, but in other cases it will be very difficult to determine the state or states in which the benefits of services are consumed. The now repealed Florida sales tax on services employed a series of statutory presumptions to determine the place of consumption of services, and even then significant ambiguities remained.¹⁴⁹

D. The Unitary Method of Apportionment and Combined Returns

1. Availability of Unitary Method as an Enforcement Tool.—The Department of Revenue may require, and the taxpayer may petition for, the filing of a combined return of the taxpayers forming part of a unitary group.¹⁵⁰ Application of the unitary method of apportionment in this manner represents a dramatic departure from the policy the Indiana legislature adopted only five years ago in connection with non-financial institutions under the adjusted gross income tax.

In Public Law number 75-1985, the legislature provided that a combined return under the unitary method could not include "under any circumstances" a foreign corporation. However, the FIT allows a combined return to include a foreign bank or its subsidiary that transacts business in Indiana (although it excludes the income of other entities organized in foreign countries). In addition, Public Law 75-1985 provided that the Department could not require combined returns "unless [it] is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through the use of other powers granted to the department" by modifying the apportionment factors, reallocating income among commonly controlled entities, or using any other means to effectuate an equitable allocation and apportionment of the taxpayer's income.¹⁵¹ Thus, under the adjusted gross income tax act, the combined return is apparently a last resort, even in the case of domestic corporations. The FIT, on the other hand, allows the Department to invoke a combined return any time that the regular taxing provisions do not "fairly represent the taxpayer's income within Indiana."¹⁵² Prior resort to alternative methods of achieving a fair reflection of income is not necessary.

Public Law number 79-1985 was adopted to confirm Indiana's policy of rarely invoking the unitary method in the past and to assure foreign

148. IND. CODE ANN. § 6-5.5-4-10 (Burns Supp. 1989).

149. See Weber, *Florida's Fleeting Sales Tax on Services*, 15 FLA. ST. U. L. REV. 613, 630 (1987).

150. IND. CODE ANN. § 6-5.5-5-1 (Burns Supp. 1989).

151. *Id.* § 6-3-2-2(p).

152. *Id.* § 6-5.5-5-1.

investors that it would not be employed aggressively in the future.¹⁵³ However, the FIT reverses this policy by making the unitary method applicable to foreign banks and fully restoring its availability as an enforcement tool to be used by the Department in administering the FIT.

2. *Consolidated Returns.*—Not only does the FIT re-establish the combined return as a viable enforcement tool, it goes to the extreme of substituting the combined return for a consolidated return.¹⁵⁴ Because the FIT contains no provision for an elective consolidated return, a combined return must be used by affiliates, including Indiana banking groups, to eliminate the effect of intercompany transactions. The FIT statute requires the affiliated group to petition the Department for permission to file a combined return¹⁵⁵ and to establish that all affiliates to be included in the return are in fact part of a unitary business as defined.¹⁵⁶ Amendment of the FIT to include an elective consolidated return option would be beneficial to affiliated corporate groups that have become accustomed to filing state and Federal tax returns on a consolidated basis.

3. *Misapplication of the Unitary Method.*—The tax base for unitary groups consists of all the adjusted gross income of residents and an apportioned percentage of the adjusted gross income of nonresident members of the unitary group. This approach appears to represent a misapplication of the unitary method of apportionment.

The unitary method is designed to determine the real economic income of entities with in-state contacts.¹⁵⁷ Under the unitary analysis, an in-state member of a unitary group is not treated as a separate taxable entity but is instead considered to be an integral part of a larger entity. The separate legal identity of the in-state entity is disregarded in determining domestic taxable income. Instead, the total income of the larger unitary group is determined and is then apportioned. The tax is computed on the income apportioned to the taxing state, and this amount is then assessed against the in-state entity. Although the effect of this method is to reach income that would otherwise be beyond a state's

153. See *Commissioner's Directive #10*, 2 [Transfer binder] IND. STATE TAX REP. (CCH) § 200-586; *Anti-Unitary Forces Win Indiana Victory, Officials Pledge Appeal*, DAILY TAX REP. (BNA) at 6-2 (June 8, 1984); and *Measure Would Clarify Purpose of Unitary Tax*, Indianapolis Star, January 6, 1985, at B8, col. 4.

154. See *supra* notes 73-79 and accompanying text.

155. IND. CODE ANN. § 6-5.5-5-1 (Burns Supp. 1989).

156. *Id.* § 6-5.5-1-18.

157. For a general overview of the theoretical rationale of the unitary method, see Rudolph, *supra* note 73, and Mohan, *The Unitary Concept Today*, 5 J. ST. TAX'N 57 (1986).

taxing jurisdiction if each legal entity were accepted as a distinct taxpayer, the usual rationale for the method is that it taxes the "true" in-state income of a unitary business by disregarding legal distinctions between entities that have no economic substance.¹⁵⁸

Under the FIT statute, however, Indiana claims all the income of the resident taxpayer regardless of where the income was earned plus the apportioned income of nonresident members of a unitary group.¹⁵⁹ The income of the nonresident group members is apportioned to Indiana by reference to the nonresidents' receipts attributable to Indiana under Indiana Code section 6-5.5-4, compared to their total receipts.

This scheme appears to be consistent with the "dual approach" advocated by Sandra McCray.¹⁶⁰ However, when applied in the context of a unitary group, this approach is theoretically inconsistent. On the one hand, the separate legal status of a resident taxpayer is disregarded for the purpose of determining whether a unitary group with in-state connections exists and whether a combined return should be required. On the other hand, the separate legal status of the resident member is used to justify the taxation of that member's total income without regard to its source. This dual approach contradicts the goal of the unitary method to tax that portion, and only that portion, of a unitary business's income derived from in-state sources.

4. *Double Taxation of Non-Bank Shareholders of FIT Taxpayers.*—The statutes contemplate that a corporation determined to be unitary with a FIT taxpayer could also be subject to other Indiana net income taxes. For example, if a FIT taxpayer is a financing subsidiary of a manufacturing or distribution company,¹⁶¹ and its parent were determined to be unitary with the subsidiary, the parent's income would be included in the unitary computation of the tax base of the FIT taxpayer. The parent could also be subject to Indiana's adjusted gross income tax and supplemental net income tax. An amendment to the adjusted gross income tax provides:

158. See Mohan, *supra* note 153, at 63-64.

159. A credit is allowed for certain taxes paid by the resident taxpayer to other states. IND. CODE ANN. § 6-5.5-2-5 (Burns Supp. 1989). The credit is designed to eliminate double taxation problems.

160. See *supra* note 7 and accompanying text.

161. A unitary group includes all entities engaged in the unitary business. Activities or operations that benefit, depend upon, or contribute to the transaction of business as a financial institution are treated as part of the unitary business. IND. CODE ANN. § 6-5.5-1-18(a) (Burns Supp. 1989). It is not difficult to imagine a situation in which the activities of a non-financial institution benefit, depend upon, or contribute to the business of an affiliated financial institution. Section 6-5.5-5-2 makes it clear that an entity may be a member of a unitary group under the FIT even though it would not be subject to the FIT on its own.

If an entity is subject to taxation under [the adjusted gross income tax] and is a member of a unitary group of which a taxpayer subject to taxation under [the financial institutions tax] is a member, all income and deductions attributable to transactions between the entity and the unitary taxpayer shall be eliminated in determining the amount of tax imposed under this article.¹⁶²

This amendment eliminates the effect of intercompany transactions but does not solve the double taxation problem. If the parent is subject to one or more of Indiana's other net income taxes, its income would be apportioned to Indiana using a three-factor apportionment formula (property, sales, and payroll).¹⁶³ Thus, the parent's income would be apportioned twice under different apportionment formulas, once as part of the FIT unitary group and again as a separate taxpayer under the adjusted gross income tax. This at least presents the potential for double taxation, especially in light of the inconsistent apportionment formulas employed by the two taxes.

E. The Adjusted Gross Income Tax Amendment

As previously noted, the nexus statute for Indiana's generally applicable net income taxes was amended to provide that a nonresident's Indiana income includes the income from certain intangibles attributed to Indiana under rules similar to those contained in the FIT statute.¹⁶⁴

This amendment calls into question the traditional position that a security interest in Indiana property, without more, is insufficient to provide tax nexus for the adjusted gross income tax. The reason for this position has been that the intangible — the loan—generally has an out-of-state situs or is otherwise not derived from doing business in Indiana.¹⁶⁵ Under the new version of that section, it would appear that making a loan secured by Indiana real or personal property would now trigger the nexus requirements provided by the statute. Therefore, the rulings previously issued by the Indiana Department of Revenue recognizing that such loans are nontaxable can no longer be relied on with any confidence.

The change in the statutory nexus rules appears to represent a substantial outward extension of the reach of the adjusted gross income

162. *Id.* § 6-3-2-15.

163. *Id.* § 6-3-2-2(b).

164. See *supra* notes 97-104 and accompanying text.

165. See, e.g., *Ruling 84-1*, 2 IND. ST. TAX REP. (CCH) § 200-619 (Jan. 17, 1984); *Ruling 79-16*, 2 IND. ST. TAX REP. (CCH) § 200-332 (Nov. 19, 1979); *Ruling DRI 78-2*, 2 IND. ST. TAX REP. (CCH) § 200-279 (Aug. 28, 1978).

tax in relationship to income from loans and other types of intangible property. If applied literally, it is likely that the amended statute would extend beyond the limits imposed by the commerce clause and due process clause in connection with many transactions. Furthermore, it is ironic that the scope of the adjusted gross income tax as it relates to lending transactions now appears to be broader than the financial institutions tax because the adjusted gross income tax lacks the safe harbors set forth in the financial institutions tax's nexus rules and does not have a regularity requirement.¹⁶⁶ It is unclear whether the legislature intended these results. However, unless and until the statute is amended again or the Department issues regulations or a position statement applying a less extensive scope than the statute's literal language, it appears that only the vague limits of the commerce clause and due process clause restrict the statute's operations. One of the significant issues on that score is whether a single, isolated secured loan could provide nexus under the Constitution on the ground that, in providing the protection of its laws and allowing the recording of the security interest, the state has afforded something to the out-of-state lender for which it can lawfully ask a return in the form of taxation.¹⁶⁷

Under the adjusted gross income tax prior to its amendment, the mere finding of nexus would normally not be a sufficient basis on which to assume that a lending transaction would result in an Indiana tax liability. The three-factor apportionment rules based on payroll, property, and sales would often result in none of the out-of-state lender's income being assigned to Indiana. That result has been modified by the recent amendments. Now, the numerator of the sales factor will include receipts from intangible property attributed to Indiana such as receipts from loans secured by Indiana property. Consequently, a lender making loans secured by Indiana property would have at least one positive factor out of three. It is believed that this was the intent of the General Assembly in enacting this amendment.¹⁶⁸

F. The Business Activity Report

The business activity report requirement was modeled in part on a Minnesota provision that also accompanied the enactment of its revised

166. See *supra* notes 38-51 and accompanying text.

167. See generally Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 TAX LAW. 37, 54-78 (1987).

168. The synopsis of the House bill as introduced contains the following language: "[I]ncludes income from intangibles in the sales factor for the adjusted gross income tax." This identical language was also contained in the synopsis for the February 28, 1989, and April 3, 1989, versions of the bill. This language suggests that the purpose of the revision to IND. CODE ANN. § 6-3-2-2 and the enactment of section 6-3-2-2.2 was not to extend the scope of the adjusted gross income tax but rather to increase the apportionment factor for those persons already subject to the tax.

method of taxing financial institutions.¹⁶⁹ However, Indiana's reporting requirement is seemingly broader than that of Minnesota. For example, the Minnesota provision excludes corporations that engage solely in safe harbor activities.¹⁷⁰ The Indiana reporting requirement extends to corporations engaging in "[a]ny activity referred to in IC 6-5.5-3."¹⁷¹ "IC 6-5.5-3" is the chapter of the FIT statute that defines what activities subject a corporation to taxation. That chapter also includes the section that defines the safe harbor transactions.¹⁷² Thus, read literally, the statute requires that a corporation engaging only in safe harbor transactions file a business activity report. It seems unlikely that the General Assembly intended to require business activity reports of those taxpayers engaged in activities that would not establish nexus for purposes of the FIT. However, as presently written, the statute arguably requires reports from all corporations engaged solely in safe harbor activities.

Failure to file a business activity report prohibits a person from pursuing in the Indiana courts any claim "[t]hat arose under Indiana law; or [o]n a contract that is executed under Indiana law."¹⁷³ This provision might be interpreted to permit a non-filing corporation to pursue causes of action in Indiana courts on a claim arising under or on a contract executed under another state's law. It is at least arguable that a contract could be insulated from the business activity report requirement by providing that it is to be governed by the law of another state.¹⁷⁴

There is no exception for suits specifically related to safe harbor activities. Thus, a corporation otherwise subject to the FIT that holds a mortgage on Indiana real property acquired in the secondary market would not be able to foreclose unless it had filed a business activity report, paid the tax, or qualified to do business in the state.¹⁷⁵

In addition, there is no exception to the general bar to use of the Indiana courts for cases related to the nonfiler's Indiana tax liability.¹⁷⁶

169. See Jagiela & Culhane, *supra* note 13, at 62-64.

170. MINN. STAT. ANN. § 290.371, subd.2(4) (West Supp. 1989).

171. IND. CODE § 6-8.1-6-6(d)(4) (1988).

172. *Id.* § 6-5.5-3-8.

173. *Id.* § 6-8.1-6-6(c).

174. The Minnesota act is clearer in barring the nonfiler from the Minnesota courts without regard to the governing law under which the cause of action arises or the contract is executed. MINN. STAT. ANN. § 290.371, subd. 4 (West Supp. 1989).

175. As a result of a 1988 amendment, the Minnesota act permits a nonfiler of a business activity report to pursue actions relating to safe harbor transactions even if the nonfiler was required to file the report and failed to do so. *Id.* § 290.371, subd. 4(b).

176. A 1989 amendment modified the Minnesota act to provide that nonfilers of the business activity report could pursue tax claims in the Minnesota courts. *Id.* § 290.371, subd. 4(a).

VIII. CONCLUSION

Indiana has joined Minnesota in aggressively seeking to tax financial institutions deriving income from Indiana residents. The FIT, as it presently exists, extends Indiana's taxing jurisdiction to corporations that previously filed no Indiana tax returns. To ensure compliance and to identify taxpayers having marginal Indiana contacts, the General Assembly also enacted a business activity reporting requirement.

Certain portions of the new taxing scheme may require modification by the General Assembly to correct provisions which probably do not represent actual legislative intent. Even with such amendments, the Department of Revenue will still be faced with numerous interpretative issues as it begins to apply the act and to issue new regulations.

ADDENDUM

The 1990 General Assembly enacted House Enrolled Act No. 1395 ("HEA 1395"), which made several amendments to the FIT statutes. The amendments generally can be characterized as technical corrections. However, certain amendments made noteworthy changes in the FIT.

The most wide reaching change is that a combined return is now presumptively required for a unitary group unless permission to file separately is obtained from the Department. As amended, IND. CODE § 6-5.5-5-1 now provides:¹⁷⁷

(a) Except as provided in this section, each taxpayer who is a member of a unitary group shall file a combined return covering all the operations of the unitary business and including all of the members of the unitary business.

(b) If the department or taxpayer determines that the result of applying this section or article does not fairly represent the taxpayer's income with Indiana or the taxpayer's income within Indiana may be more fairly represented by a separate return, the taxpayer may petition for and the department may allow, or the department may require, in respect to all or a part of the taxpayer's business activity any of the following:

- (1) Separate accounting.
- (2) The filing of a separate return for the taxpayer.
- (3) A reallocation of tax items between a taxpayer and a member of the taxpayer's unitary group.

177. HEA 1395, § 30 amended IND. CODE ANN. § 6-5.5-5-1 (Burns Supp. 1989), which is quoted *supra* at text accompanying n.75. The new version is effective retroactively as of January 1, 1990, the date that the FIT became effective. HEA 1395, § 63.

This amendment confirms the radical change in legislative policy from the use of a combined (unitary) return only as a last resort to a statutory preference for such returns as the general rule.¹⁷⁷

The 1990 legislation also appears to have addressed the potential double taxation of non-financial institution members of unitary groups.¹⁷⁹ HEA 1395 added amendatory language to the definition of unitary businesses that requires each member of a unitary business filing a combined FIT return to be engaged in the business of a financial institution.¹⁸⁰ Thus, a corporate parent of a corporation subject to the FIT that has little or no income from quasi-banking activities (for example, a manufacturing parent with a financing subsidiary), should be excluded from a combined FIT return.

An ambiguity in the apportionment rules was also affected by the new legislation. As previously noted, nonresidents' income is apportioned according to a single factor receipts formula.¹⁸¹ The original language defined "receipts" as "all gross income, including net taxable gain on disposition of assets such as securities and money market transaction, when derived from transactions and activities in the regular course of the taxpayer's trade or business."¹⁸² These provisions could be interpreted as maintaining a distinction between business income and nonbusiness income.¹⁸³ Such an interpretation is buttressed by IND. CODE § 6-5.5-4-14, which provides that income unconnected with a taxpayer's trade or business is to be "allocated" to the taxpayer's domicile. Thus, it appeared that the distinction between business and nonbusiness income was incorporated into the FIT statutes.

HEA 1395 altered the definition of "receipts" to provide:¹⁸⁴

"Receipts" includes all gross income (as defined in IC 6-5.5-1-10) [incorporating the definition under Section 61 of the Internal

178. See discussion of this policy change *supra* at notes 150-53 and accompanying text.

179. See discussion of the potential problem under prior statutory language *supra* at notes 161-163 and accompanying text.

180. IND. CODE ANN. § 6-5.5-1-18(a) (Burns Supp. 1989), as amended by HEA 1395, § 19.

181. See discussion *supra* text accompanying notes 66-69.

182. IND. CODE ANN. § 6-5.5-4.2(1) (Burns Supp. 1989).

183. Business income is income derived from transactions in the regular course of a taxpayer's trade or business. Nonbusiness income is all other income, consisting primarily of income from investments that are unrelated to the taxpayers business activities. Cf. 45 IND. ADMIN. CODE § 3.1-1-29. As a general rule, business income is *apportioned*; that is, it is assigned to a taxing state on the basis of an apportionment formula. See, e.g., IND. CODE ANN. §§ 6-3-2-2(b) to (e) (Burns Supp. 1989). Nonbusiness income, on the other hand, is generally *allocated* to a specific state. See, e.g., *id.* §§ 6-3-2-2(h) to (k).

184. HEA 1395, § 29, amending IND. CODE ANN. 6-5.5-4-2 (Burns Supp. 1989).

Revenue Code]. However, upon the disposition of assets such as securities and money market transaction, when derived from transactions and activities in the regular course of the taxpayer's trade or business, receipts are limited to the gain (as defined in Section 1001 of the Internal Revenue Code) that is recognized upon the disposition.

The first sentence appears to clarify that all gross income—including both business and nonbusiness income—is included in the definition of receipts. Receipts are then assigned to a particular location under the receipt attribution rules.¹⁸⁵ Thus, the amendment appears to have done away with the business/nonbusiness income distinction for FIT purposes.

Under one of the 1990 amendments,¹⁸⁶ leasing activities are counted toward the income percentage test¹⁸⁷ only if the leasing transactions are not true leases for federal income tax purposes. This amendment should remove a typical leasing specialty company from the coverage of the FIT.

Under the type of business requirement,¹⁸⁸ the definition of a "regulated financial corporation" has been amended to remove a subsidiary of a foreign bank as an entity automatically treated as meeting the type of business requirement.¹⁸⁹ However, an agency or branch of a foreign bank is still included within the definition.¹⁹⁰ In addition, the definition of the "business of a financial institution" has been amended to remove the activities of a foreign bank as a category that is treated as automatically meeting the type of business requirement.¹⁹¹

Corporations that are generally exempt from federal income taxation under the Internal Revenue Code are exempt from the FIT (except to the extent of the corporation's unrelated business income).¹⁹²

Finally, one ambiguity concerning the effect of the failure to file a business activity report was removed.¹⁹³ A party required to file a report who fails to do so is barred from the use of the Indiana courts with respect to any contract that is "enforceable" under Indiana law.¹⁹⁴

185. IND. CODE §§6-5.5-4-1 to -15 (Burns Supp. 1989). See discussion of these rules *supra* text accompanying notes 80-96.

186. HEA 1395, § 18.

187. See *supra* notes 33-37 and accompanying text.

188. See *supra* notes 28-32 and accompanying text.

189. See IND. CODE ANN. § 6-5.5-1-17(c)(7), as amended by HEA 1395, § 18.

190. *Id.*

191. *Id.* § 6-5.5-1-17(d)(1), as amended by HEA 1395, § 18.

192. IND. CODE ANN. § 6-5.5-2-7(4) (Burns Supp. 1989), as amended by HEA 1395, § 25.

193. See notes 173-74 and accompanying text.

194. IND. CODE ANN. § 6-8.1-6-6 (Burns Supp. 1989), as amended by HEA 1395, § 38.

Before the amendment, the bar applied only to contracts "executed" under Indiana law.

Survey of Recent Developments in Tort Law

JOHN R. TALLEY*

I. INTRODUCTION

Changes in Indiana tort law occurred through a number of important court decisions and several legislative changes during the survey period.¹ The Indiana Supreme Court adopted a new analysis for governmental liability,² interpreted accrual requirements for a tort action for statute of limitations purposes,³ and extended attorney liability to known third party beneficiaries of legal services.⁴ The Indiana General Assembly enacted a statute governing recovery of prejudgment interest in tort actions,⁵ expanded the types of claims that can survive the death of a plaintiff when the death results from a cause unrelated to a tort,⁶ and expanded the ceiling on damage awards under the Indiana Medical Malpractice Act.⁷ These changes, significant alone, were joined by important decisions of the Indiana Court of Appeals which recognized a cause of action for loss of consortium by children based on injury to a parent,⁸ and which continued to interpret the Indiana Comparative Fault Act ("Act" or "Comparative Fault Act").⁹

This Article focuses on decisions in the following areas: (1) interpretations and applications of the Indiana Comparative Fault Act; (2) governmental liability law; (3) Indiana's new statute on prejudgment interest in tort actions; (4) a "discovery rule" for tort statute of limitations purposes; (5) a cause of action for loss of consortium by children

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1. Approximately July 31, 1988, to July 31, 1989.

2. *Peavler v. Bd. of Comm'r's of Monroe County*, 528 N.E.2d 40 (Ind. 1988). *See infra* notes 71-121 and accompanying text.

3. *Burks v. Rushmore*, 534 N.E.2d 1101 (Ind. 1989). *See infra* notes 168-81 and accompanying text.

4. *Walker v. Lawson*, 526 N.E.2d 968 (Ind. 1988). *See infra* notes 196-205 and accompanying text.

5. IND. CODE § 34-4-37-1 (1988). *See infra* notes 152-67 and accompanying text.

6. Pub. L. No. 94-1989, § 4, 1989 Ind. Acts 961, 962 (making changes expanding the type of damages recoverable in such actions) codified at IND. CODE ANN. § 34-1-1-1 (Burns Supp. 1989).

7. IND. CODE §§ 16-9.5-1-1 to -10-3 (1988).

8. *Dearborn Fabricating and Eng'g Corp. v. Wickham*, 532 N.E.2d 16 (Ind. Ct. App. 1988), *petition for transfer pending*.

9. IND. CODE §§ 34-4-33-1 to -14 (1988). *See infra* notes 11-70 and accompanying text.

based on personal injury to a parent; and (6) liability to known third party beneficiaries of professional services.

II. COMPARATIVE FAULT

Case law interpretation of the Comparative Fault Act continued to inch forward during the survey period. During this period, the Indiana Court of Appeals has provided some guidelines as to the troublesome "nonparty" defense, has addressed allocations of liability, and has discussed application of factors considered in determining the existence of a duty of care.

A. *The Nonparty Defense—Identification or Specific Name?*

The question of whether an unnamed nonparty can be allocated fault by a fact-finder is not explicitly addressed in the Indiana Comparative Fault Act, an omission that is perhaps the Act's most glaring oversight. The Act does, however, contain seemingly conflicting references to nonparties, leaving unclear whether the legislature intended to permit fault to be allocated to a nonparty when the nonparty is merely identified by description, rather than specifically identified by name prior to allocation of fault by the fact finder.

Indiana Code section 34-4-33-2 defines a nonparty as "a person who is, or may be, liable to the plaintiff in part or in whole for the damages claimed but who has not been joined in the action as a defendant by the claimant. A nonparty shall not include the employer of the claimant." Neither this provision, nor Indiana Code section 34-4-33-10, which establishes the affirmative nonparty defense, specifically provides the extent to which a nonparty must be identified.¹⁰

A provision of the Act concerning the forms of verdict to be furnished to the jury, however, states in part: "If the evidence is sufficient to support the charging of fault to a nonparty, the form of verdict also shall require a disclosure of the name of the nonparty and the percentage of fault charged to the nonparty."¹¹ The latter provision has prompted an argument that a nonparty must be specifically named before fault can be allocated.¹² Commentators have split on the issue.¹³

10. IND. CODE § 34-4-33-10 (1988) provides in part: "In an action based on fault, a defendant may assert as a defense that the damages of the claimant were caused in full or in part by a nonparty."

11. IND. CODE § 34-4-33-6(2) (1988) (emphasis supplied).

12. See Wilkins, *Indiana Comparative Fault Act at First (Lingering) Glance*, 17 IND. L. REV. 687, 739 (1984).

13. Compare Wilkins, *supra* note 13 with Eilbacher, *Comparative Fault in the Non-Party Tort Feasor*, 17 IND. L. REV. 903, 920 (1984).

Although the verdict provision appears to require the nonparty to be named, the provision is placed at an unusual location in the Act for a provision that would impact both the provision creating the defense and the provision defining a "nonparty" so drastically. Further, even the provision requiring a name does not clarify whether a "John Doe" or "Jane Doe" designation would be sufficient. Legislative intent on the issue is not explicit from the statute and must be inferred.

B. *Cornell Harbison Excavating, Inc. v. May*

The Indiana Court of Appeals considered these issues in *Cornell Harbison Excavating, Inc. v. May*¹⁴ and concluded a nonparty must be specifically named before any fault allocation may be made to the nonparty.

Cornell arose from an automobile accident that resulted after a dog ran in front of a car driven by May. May's car swerved and struck drainage and sewer pipes left near the road by Harbison. May sued alleging negligence by Harbison in storing the pipes next to the roadway. Harbison asserted a nonparty defense in its answer, naming two specific nonparties and identifying a third nonparty as the "unknown owner of the dog."¹⁵ May moved to strike the nonparty defense as to the unknown dog owner, arguing that the Act requires each nonparty to be specifically named. The trial court granted the motion and Harbison filed an interlocutory appeal.

On appeal, May argued the verdict provision of the Act,¹⁶ which appears to require a nonparty to be named, fulfilled legislative intent to maximize recovery where nonparties cannot be specifically identified.¹⁷ Harbison, on the other hand, argued comparative fault was designed to completely and accurately allocate fault to all responsible tortfeasors, whether or not they are parties. This purpose could only be satisfied by allowing as complete a description of an unnamed nonparty as possible under the particular circumstances.¹⁸

The court noted that both commentators and courts of other jurisdictions have advocated the allocation of fault to unnamed and un-

14. 530 N.E.2d 771 (Ind. Ct. App. 1988). After preparation of this Article, but shortly before publication, the Indiana Supreme Court granted transfer and affirmed the Court of Appeals' decision in *Cornell Harbison Excavating, Inc. v. May*, 546 N.E.2d 1186 (Ind. 1989). The Indiana Supreme Court found the "plain meaning and clear language" of section 6 of the Comparative Fault Act to "unmistakably require the disclosure of 'the name of the nonparty,' not merely a generic identification." *Id.* at 1187.

15. *Id.* at 772.

16. IND. CODE § 34-4-33-6 (1988).

17. *Cornell*, 530 N.E.2d at 772-73.

18. *Id.*

identified nonparties.¹⁹ Given the verdict provision in the Indiana Act, however, the court reached a different result. The court reasoned that it would be inconsistent for the Act to require "a disclosure of the name of the nonparty"²⁰ if the legislature had intended a mere identification to be sufficient. Thus, the court inferred a legislative intent to prevent allocation of fault to unnamed nonparties and held the nonparty defense was properly dismissed.²¹

Both parties in *May* appear to have presented useful policy arguments which may favor a finding of legislative intent in either direction. Because legislative intent is not clear, neither argument appears inherently more correct. The court followed the most literal interpretation of the verdict provision, consistent with general rules of statutory construction.²²

C. *Faust v. Thomas*

In *Faust v. Thomas*²³ the identification of the nonparties was provided during the course of the litigation, as opposed to identification of the nonparties being provided in the defendants' answer. The action concerned injuries to a child, Andrea Faust, who had attended a church function with her aunt, Amelia Culpher. When Culpher became busy with other matters, she asked thirteen year-old Ericka Yates to watch Andrea. Yates failed to prevent Faust from running into the nearby street where Faust was hit by a car driven by Thomas.²⁴ When Faust sued, Thomas pled a general affirmative defense stating that nonparties were at fault, but did not name a specific nonparty.²⁵

After the jury found Culpher, the nonparty, to have been sixty-six and two-thirds percent at fault, Faust appealed, asserting Thomas did not timely plead the nonparty defense as the nonparty had not been named in Thomas' answer.²⁶ Thomas' nonparty defense merely pled a general defense, asserting "[t]hat nonparties other than the plaintiff and the defendant were at fault, said nonparties contributing to the cause of any accident herein."²⁷ Thomas later provided specific names of the

19. *Id.*

20. IND. CODE § 34-4-33-6(2) (1988).

21. *Cornell*, 530 N.E.2d at 774. The court was also persuaded by arguments based on amendments to the act prior to its effective date. *Id.* at 773.

22. Where the intention of the legislature is clear, the court's duty is to give effect to the plain language of the statute. See, e.g., *Dague v. Piper Aircraft & Co.*, 275 Ind. 520, 524, 418 N.E.2d 207, 210 (1981).

23. 535 N.E.2d 164 (Ind. Ct. App. 1989).

24. *Id.* at 165.

25. *Id.* at 166.

26. *Id.*

27. *Id.*

nonparties claimed to be at fault. Those names were included in the court's pretrial order narrowing issues.²⁸ Neither party contended that the nonparty defense had not been asserted within the time to give the plaintiff at least forty-five days to add the nonparties as defendants before the applicable statute of limitations against the nonparties expired.²⁹ Indeed, the nonparty was included in a pre-trial order entered January 15, 1987, which apparently provided plaintiff more than seven months to file claims against the nonparties.³⁰

The court noted that neither Indiana Code section 34-4-33-2, which defines nonparty, nor Indiana Code section 34-4-33-10, which establishes the nonparty defense specifically, addresses the question of whether a nonparty must be named or merely identified.³¹ The court did not cite or discuss *Cornell* as it related to this issue, and in fact explicitly avoided addressing the *Cornell* question of whether a nonparty defense must fail unless the parties can produce the name of the nonparty.³²

The court rejected the plaintiff's claims of delay as unjustified because the plaintiff had not shown any effort to force the defendant to reveal his nonparty contentions, either through discovery, a request for a pretrial conference, or a request for a scheduling order.³³ Plaintiff thus had not shown diligence in seeking specific contentions from defendant regarding the nonparty defense. Because the nonparty had been named by the time of the pretrial conference and had been included in the pre-trial order entered to formulate the issues for trial, the court found no abuse of discretion in permitting submission of the nonparty defense to the jury.

In *Faust*, defendant's answer apparently was not amended to include the name of the subsequently identified nonparty. Inclusion of the names in the pretrial order was sufficient, however, to put the nonparty defense at issue.³⁴ *Faust*, therefore, apparently allows a nonparty defense to be presented to the jury even though the names of the nonparties are not included in the defendant's pleadings. *Faust* also suggests defendants may plead a nonparty defense, if reasonably warranted, and allow specific naming of the nonparties to be discovered or required by pretrial order. Under *Faust*, the plaintiff must demonstrate diligence in investigating

28. *Id.* at 167.

29. *Id.* at 166-67. See IND. CODE § 34-4-33-10(c) (1988).

30. *Id.* at 167.

31. *Id.*

32. See *supra* notes 14-24 and accompanying text.

33. 535 N.E.2d at 167; (resolution of that issue, however, was not essential to the court's holding that the initial pleading "that non-parties were at fault" required amplification to be presented to the jury).

34. *Id.*

the defendant's contentions regarding nonparties, or be held to have waived any right to complain of delay in identification. *Cornell*, however, suggests a nonparty defense that does not name the nonparty is subject to an immediate motion to strike.³⁵ In this respect, *Faust* appears to be more consistent with theories of notice pleading, requiring only fair notice of defenses.³⁶

D. Allocation of Fault

Proper allocation of fault by the fact finder was at issue in *Brown v. Conrad*.³⁷ In *Brown*, the court found the refusal of the jury to award damages despite an instruction from the trial court that defendant was 100% at fault, was an error requiring a new trial.

Uncontroverted trial evidence indicated Conrad stopped his car at a traffic light, where the car was struck from behind by the defendant's vehicle.³⁸ The trial court instructed the jury, without objection, that the defendant was 100% at fault.³⁹ Despite this instruction, the jury refused to award the plaintiff damages, even in light of undisputed evidence that Conrad suffered at least some damages. The court of appeals found that the trial court's instruction that Brown was 100% at fault was, in effect, a directed verdict for plaintiffs on the issue of liability. Under such circumstances, the jury's refusal to award damages contravened its limited role.⁴⁰ Accordingly, the appellate court affirmed the order of a new trial.⁴¹

In *Wilson v. Riddle*,⁴² an allocation of fault that left both the plaintiff and the defendant without recovery on claims arising from the

35. See IND. R. TR. P. 17; Whiteco Indus. v. Kopani, 514 N.E.2d 840 (Ind. Ct. App. 1987), *trans. denied* (1988).

36. See IND. R. TR. P. 8. Given the Indiana Supreme Court's recent affirmance of *Cornell*, however, see *supra* note 14, *Cornell* appears to govern this issue.

37. 531 N.E.2d 1190 (Ind. Ct. App. 1988).

Faust is also significant for implicitly approving the trial court's instruction to the jury based on intervening cause. Plaintiff tendered the instruction seeking to have the jury find Culpher not legally responsible for the injury and Thomas to be the intervening cause of the accident. *Faust* contended editing done by the trial court on the tendered instruction was error. The court of appeals disagreed and found no prejudice to plaintiff from the amendment.

Faust also approved a jury verdict form for assessing fault. Given that other instructions advised the jury of the requirements of finding negligence and causation before assessing liability, the form was approved against challenges that it was confusing, misleading, or mandated a determination that non-parties were negligent.

38. 531 N.E.2d at 1191.

39. *Id.*

40. *Id.*

41. *Id.* at 1194.

42. 540 N.E.2d 629 (Ind. Ct. App. 1989).

same accident was considered. Wilson sued Riddle for damages arising from an automobile accident. Riddle's nonparty defense was that Wilson's son was at fault, and separately filed a third-party complaint against Wilson's son. The case was tried to the court which determined that both drivers were at fault and that both should lose because the court could not "attribute more negligence to either party."⁴³

The court of appeals concluded that the judgment was contrary to law for two reasons. First, the judgment suggested fault was allocated only between the plaintiff and defendant, ignoring the requirement of the act to allocate fault to nonparties.⁴⁴ Secondly, the judgment appeared to allocate not more than 50% of the fault to the claimant, in which event, "the court was required [under the Act] to determine the total amount of damages the claimant would be entitled to recover and to multiply the percentage of fault of the defendant by the amount of damages determined."⁴⁵ If such a determination is made, a verdict is required against the defendant and in favor of claimant.

Wilson appears to be a straightforward application of the Comparative Fault Act. Perhaps the most significant impact is its requirement that an allocation of fault be made as to nonparties, a requirement that may affect verdict forms in jury actions and require the jury to be explicit in how, or whether, the nonparties have been allocated a portion of fault.

E. Application To Governmental Entities

In *Governmental Interinsurance Exchange v. Khayyata*,⁴⁶ the court considered the applicability of the Comparative Fault Act to claims against governmental entities.

Khayyata collided with a Delaware County ambulance in Muncie, Indiana. Khayyata sustained property damages in the collision, but did not notify the county of a tort claim within 180 days of the accident as required by the notice provision of the Indiana Tort Claim Act⁴⁷ ("Tort Claims Act" or "ITCA"). The insurer for the governmental entity intentionally allowed the 180 day notice period⁴⁸ to run before initiating an action against Khayyata for damages. Khayyata responded by an answer and a counterclaim, alleging that the county's driver was

43. *Id.* at 629-30.

44. *Id.* at 630. (*Wilson* apparently requires an allocation of fault must be made to a non-party, even if that allocation is 0%.)

45. 540 N.E.2d at 630.

46. 526 N.E.2d 745 (Ind. Ct. App. 1988).

47. IND. CODE § 34-4-16.5-1 (1988).

48. See IND. CODE § 34-4-16.5-7 (1988).

negligent and that the county was liable under the doctrine of respondeat superior.

The court of appeals concluded that the claim against the governmental entity was barred by failure to comply with 180 day notice period of the Tort Claims Act,⁴⁹ but that Indiana Trial Rule 13(J) applied to permit assertion of the counterclaim to the extent it diminished or defeated the county's opposing claim.⁵⁰ As to the legal rules applicable to the counterclaim, the court held the exemption in the Comparative Fault Act which prevents application of comparative fault to claims against a governmental entity required common law negligence, rather than comparative fault, to govern Khayyata's counterclaim.⁵¹ Under this holding, contributory negligence by the county did not bar its claim against Khayyata, but any contributory negligence by Khayyata could bar her counterclaim.

Khayyata successfully argued to the trial court that exempting governmental entities from allocations of fault on the counterclaim would be unjust and extremely harsh by allowing a governmental entity up to 50% at fault to recover all or a portion of its loss, while raising relatively slight contributory negligence as a bar to a counterclaim.

The court of appeals acknowledged "that there are inequities occasioned by the application of the governmental entity exception"⁵² and application of the exemption would present "practical difficulties in instructing the jury and conducting the trial."⁵³ Nonetheless, the court found the meaning of the legislative enactment "clear and unambiguous" and found any contrary interpretation "would ignore both the letter and intent of the statute."⁵⁴

The *Khayyata* interpretation of the exemption in Comparative Fault Act of state and local governmental entities results in an uneven playing field in disputed claims brought by governmental entities. The statute exempting governmental entities from application of comparative fault principles may have been passed with an intention to protect governmental entities from a flood of claims related to alleged fault in failing to administer governmental policy and planning processes. The statute appears designed to prevent the government's defensive arsenal from being stripped of the contributory negligence defense. The statute does not

49. A claim is barred against a political subdivision unless notice of that claim is filed with the governing body of the political subdivision within 180 days after the loss occurs. IND. CODE § 34-4-16.5-7 (1988).

50. 526 N.E.2d at 746.

51. *Id.*

52. *Id.* at 747.

53. *Id.*

54. *Id.*

appear to be designed to promote the offensive arsenal of a governmental entity by tilting disputed claims brought by such entities in their favor.

Two legislative changes could be considered as alternative methods for dealing with the inequity presented in *Khayyata*: (1) a provision that the Act applies to a counterclaim brought against an entity; or (2) a provision that tort claims brought by governmental entities are governed by common law negligence. Either of these alternatives would prevent the government taking the benefit of comparative fault and leaving its detriments behind.

F. Comparative Fault's Effect on Ameliorative Negligence Doctrines

In *Roggow v. Mineral Processing Corp.*⁵⁵ the court considered application of the common law doctrines of "last clear chance" and superseding and intervening causes in a comparative fault context. The court determined that the doctrines of last clear chance and superseding and intervening causes were common law doctrines developed to alleviate the harsh results of contributory negligence and that the doctrines should no longer be applied to completely excuse negligence by a plaintiff.⁵⁶ The court cited holdings from twenty jurisdictions supporting its reasoning.⁵⁷

Roggow examined superseding and intervening cause in the context of a plaintiff trying to avoid assignment of fault. As demonstrated in *Faust*, similar issues can also arise in the context of a plaintiff arguing a nonparty should not be found at fault because the defendant's fault was an intervening cause that should alleviate fault by the nonparty. In that context, the court of appeals ruled instructing the jury on intervening cause was not error.⁵⁸ *Faust* and *Roggow* are not contradictory when this distinction in context is considered. As to fault comparisons between plaintiff and defendant, *Roggow* is significant for its holding that superseding or intervening cause is superfluous to a general consideration of fault under the Act. The traditional doctrines, however, may retain continued validity in other fault contexts.

G. Considering Whether a Duty of Care is Present

The Indiana Comparative Fault Act has dramatically changed the governing philosophy of tort compensation in Indiana. In its wake, dozens of well established and long applied doctrines will tumble. Fun-

55. 698 F. Supp. 1441 (S.D. Ind. 1988).

56. *Id.*

57. *Id.* at 1445.

58. *Faust v. Thomas*, 535 N.E.2d 164, 169 (Ind. Ct. App. 1989).

damental tort precepts will need new scrutiny for continued usefulness. In *Harper v. Guarantee Auto Stores*,⁵⁹ the court of appeals engaged in an extended discussion of one fundamental element of tort law, the duty to exercise care for the safety of another. The "nonparty" defense and the allocation of fault among all tortfeasors force Indiana practitioners to search the bounds of negligence to identify all who may share "fault" under the Act. The first step in any such analysis should be to examine whether a duty existed upon which fault can be premised. *Harper* provides a useful starting point in such a consideration.⁶⁰

Guarantee Auto Stores ("Guarantee Auto") had installed a tire on the automobile of Barbara Hacker, a codefendant in the action. A Guarantee Auto employee allegedly replaced the spare tire in the wheel well of Hacker's automobile, which well was located in the passenger compartment. The employee allegedly failed to firmly secure the tire jack when the spare tire was replaced. Three months later, Hacker drove her vehicle into a utility pole and Harper, a passenger, was allegedly struck in the back of the head by a sharp projectile. Harper alleged the unrestrained tire jack flew forward and struck him. Harper sued Guarantee Auto, among others, asserting negligence. Guarantee Auto obtained summary judgment from the trial court and Harper appealed.

Guarantee Auto successfully argued to the trial court that Hacker's subsequent conduct in driving the vehicle into a utility pole was not reasonably foreseeable and was an intervening cause which relieved Guarantee of liability.⁶¹ Harper argued that questions of fact were present regarding foreseeability which made summary judgment inappropriate.⁶²

Traditionally, a duty to exercise care for the safety another arises as a matter of law out of some relationship existing between the parties, and the question of whether such relation gives rise to a duty is a question of law to be determined by the court.⁶³ Factual questions may be interwoven which could render the existence of a duty a mixed question of law and fact to be resolved by the fact finder.⁶⁴

In this action, the alleged duty was premised on the agreement by Guarantee Auto to perform certain repairs. The court rejected contentions by Guarantee Auto that Indiana law precludes tort liability for personal injury arising from performance of contractual duties unless privity is

59. 533 N.E.2d 1258 (Ind. Ct. App. 1989).

60. For another recent decision discussing the duty of care, see *Snyder Elevators, Inc. v. Baker*, 529 N.E.2d 855 (Ind. Ct. App. 1988).

61. *Harper*, 533 N.E.2d at 1261.

62. *Id.*

63. *Id.*

64. *Id.*

present, citing *Baker v. Midland-Ross Corp.*,⁶⁵ which adopted Section 324A of the Restatement (Second) of Torts:

One who undertakes, gratuitously or for consideration, to render services to another, which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if

- (a) his failure to exercise reasonable care increases the risk of such harm, or
- (b) he has undertaken to perform a duty owed by the other to the third person, or
- (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.⁶⁶

Although this section is most frequently cited in cases where a failure to inspect has been alleged, comment (b) makes clear this section applies to *any* undertaking to render services resulting in physical harm to third persons where there is negligence in the manner of performance, or a failure to exercise reasonable care to complete it or protect third persons when the undertaking is discontinued.⁶⁷

The court analyzed the elements of an action brought on such a theory as follows:

To establish liability under § 324(A), Harper must demonstrate that Guarantee engaged in an undertaking to render services, and, either: (1) that the risk of harm to Harper increased due to Guarantee's failure to exercise reasonable care; (2) that Guarantee undertook to perform a duty owed by Hacker to Harper; (3) that the harm suffered by Harper was a consequence of Hacker's reliance on services rendered by Guarantee. In addition, Harper must show that Guarantee should have recognized the careful execution of its undertaking was necessary for the protection of Harper.⁶⁸

65. 508 N.E.2d 32 (Ind. Ct. App. 1987).

66. RESTATEMENT (SECOND) OF TORTS § 323 (1965) [hereinafter RESTATEMENT].

67. Cf. RESTATEMENT (SECOND) OF TORTS § 324A, comment c, illustration 1 (1965). Where the damages sought are for intangible economic losses, contract law still governs. PROSSER AND KEETON ON TORTS, § 92 at 657 (1984) [hereinafter PROSSER]. This requirement has eroded in economic harm cases, particularly where the contract was for professional services to benefit a known third party. See *Hermann v. Frey*, 537 N.E.2d 529, 531 (Ind. Ct. App. 1989); see also, Annotation, *Attorney's Liability To One Other Than His Immediate Client For Consequences of Negligence in Carrying Out Legal Duties*, 45 A.L.R.3d 1181 (1972).

68. 533 N.E.2d at 1262.

Having determined factual issues existed regarding whether Harper could demonstrate all necessary elements, the court concluded summary judgment was inappropriate on the element of duty.

The court next considered arguments by Guarantee that any negligence by it could not have been the proximate cause of Harper's injuries. The court rejected this argument, stating "if the actor's conduct is a substantial factor in bringing about harm to another, the fact that the actor neither foresaw nor should have foreseen the extent of harm or the manner in which it occurred does not preclude liability."⁶⁹ The court held Guarantee might be liable "if Guarantee's conduct was a substantial factor in bringing about the complained of injury or a reasonable person would have recognized that harm from the tire or jack would occur in substantially this manner."⁷⁰ Because the evidence presented did not establish that reasonable minds might not differ on those issues, the court concluded the question of proximate cause should not have been removed from the jury.

Harper does not appear to expand or change existing negligence law, but provides a framework to analyze duty of care questions which increasingly confront Indiana practitioners as comparative fault forces plaintiffs to seek even remote tortfeasors.

III. DECISIONS AFFECTING MUNICIPAL LIABILITY

A. Adoption of the Planning/Operational Analysis

1. *Procedural Background.*—In *Peavler v. Monroe County Board of Commissioners*⁷¹ the Indiana Supreme Court adopted a new analysis of governmental immunity that focuses on whether a certain activity was part of a governmental planning process or an operational function. This analysis will govern inquiries as to whether a governmental entity is immune from liability under the discretionary function exception to the Indiana Tort Claims Act.

Peavler sued the Monroe County Board of Commissioners alleging negligence in the failure to place warning signs on a portion of a country road. After a jury verdict for the county, the court of appeals found the trial court erred by instructing the jury that any duty on the part of the county to post warning signs was discretionary.⁷² The court of

69. *Id.* at 1264.

70. *Id.*

71. 528 N.E.2d 40 (Ind. 1988).

72. *Peavler v. Board of Comm'rs of Monroe County*, 492 N.E.2d 1086, 1087 (Ind. Ct. App. 1986).

appeals concluded Peavler had presented a jury issue on the question of immunity, and a new trial was required.⁷³

In a separate action, Ronald and Pamela Hout sued the Steuben County Board of Commissioners, alleging a negligent failure to place a warning sign for motorists approaching a certain intersection. The county unsuccessfully sought summary judgment on the basis of governmental immunity. The county made an interlocutory appeal in which the court of appeals determined the alleged negligent failure to place a warning sign was a discretionary act for which the county was immune.⁷⁴

The Indiana Supreme Court granted transfer in both cases to resolve the conflict between the districts of the Indiana Court of Appeals.⁷⁵

2. *Prior Law.*—Governmental immunity has its historical basis in the doctrine of sovereign immunity, which served both procedural and substantive purposes.⁷⁶ Procedurally, allowing the king to be sued in his own courts was a contradiction of the king's sovereignty.⁷⁷ Substantively, the divine right of kings proclaimed the king could do no wrong.⁷⁸

American common law does not provide a clear explanation for the initial acceptance of sovereign immunity in the United States.⁷⁹ A version of sovereign immunity was adopted in early United States Supreme Court decisions holding no suit could be commenced against the United States without its consent.⁸⁰ American state courts subsequently held certain principles of sovereign immunity extended to the states.⁸¹

Immunity for local governments, such as cities, towns and counties, has a slightly different origin.⁸² Municipal corporations have dual capacities as both a subdivision of the state with governmental powers and a private corporate body. Governmental immunity was extended to acts which were part of the "traditional governmental functions" of a municipality, whereas acts which were part of the "proprietary" capacity of the municipal corporation might not be immune.⁸³

Although this governmental/proprietary distinction arose from municipal law, it was later applied to state immunity as well. The classification of governmental or proprietary actions, however, was problematic.

73. *Id.* at 1090.

74. *Board of Comm'r's of County of Steuben v. Hout*, 497 N.E.2d 597, 598 (Ind. Ct. App. 1986).

75. *Peavler*, 528 N.E.2d at 40-41.

76. PROSSER, *supra* note 67, at 1033.

77. *Id.*

78. *Id.*

79. *Peavler*, 528 N.E.2d at 41.

80. *Osborne v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 842-43 (1824).

81. *Peavler*, 528 N.E.2d at 41.

82. PROSSER, *supra* note 67, at 1051.

83. See *City of Kokomo v. Loy*, 185 Ind. 18, 112 N.E. 994 (1916).

Distinctions were "elusive and uncertain and often led to inconsistent results."⁸⁴ In response, Indiana Supreme Court abandoned the governmental/proprietary distinction in *Campbell v. State*, in favor of a discretionary/ministerial test.⁸⁵ Two years later, the Indiana General Assembly enacted the ITCA,⁸⁶ which also incorporated discretionary/ministerial distinction. Although governmental liability is possible under ITCA, it is subject to a general exception which provides immunity from discretionary functions.⁸⁷ Unfortunately, the ITCA does not define "discretionary" or delineate any particular application for the exception.

In interpreting the "discretionary function" exception to ITCA, Indiana has traditionally used an analysis that required a determination whether the exercise of judgment played a role in the conduct.⁸⁸ If so, the conduct was generally found immune. Under that analysis:

A duty is discretionary when it involves on the part of the officer to determine whether or not he should perform a certain act, and if so in what particular way, and in the absence of corrupt motives, in the exercise of such discretion, he is not liable. His duties, however, in the performance of the act, after he has once determined that it shall be done, are ministerial, and for negligence in such performance, which results in injury, he may be liable in damages.⁸⁹

This analysis of "discretionary function" seems to presume any governmental act involving some choice, judgment, or decision-making is discretionary and therefore immune.⁹⁰ An act has been defined as ministerial when it constituted conduct that was found not to be discretionary.⁹¹

Commentators and the Indiana Supreme Court have long recognized problems exist with the discretionary/ministerial analysis.⁹² Because almost every act, no matter how small, involves some measure of discretion in its performance, distinctions were still problematic.⁹³ To the extent discretionary functions included every act with any element of choice,

84. *Peavler*, 528 N.E.2d at 42.

85. 259 Ind. 55, 284 N.E.2d 733 (1972).

86. IND. CODE §§ 34-4-16.5-12 to -20 (1988).

87. IND. CODE § 34-4-16.5-3(6) (1988).

88. *Rodman v. City of Wabash*, 497 N.E.2d 234 (Ind. Ct. App. 1986).

89. *Adams v. Schnaiter*, 71 Ind. App. 249, 255-56, 124 N.E. 718, 720 (1919) (citations omitted).

90. *Peavler*, 528 N.E.2d at 43.

91. *Id.* at 45-46.

92. *Id.* at 43.

93. *Id.*

judgment, or ability to make a responsible decision, virtually every act fell within the exception.⁹⁴

An alternative analysis emerged primarily from interpretation of federal statutory immunity. The Federal Tort Claims Act,⁹⁵ (FTCA) passed in 1946, governs tort liability by the federal government and contains an exception similar to ITCA, which provides immunity for the exercise of a "discretionary function or duty."⁹⁶

When the FTCA was interpreted by the United States Supreme Court,⁹⁷ the court rejected the traditional governmental/proprietary distinction calling it a "quagmire that has long plagued" the law of municipal corporations by leading to "irreconcilable" conflicts demonstrating "the inevitable chaos" of a rule of law "that is inherently unsound."⁹⁸

The Supreme Court instead determined that discretionary acts are entitled to immunity when the alleged negligence arises from decisions "responsibly made at a planning rather than operational level" which involve "considerations more or less important to the practicability" of the government's operation or program.⁹⁹ Unlike the discretionary/ministerial analysis, this standard recognized that allowing immunity for discretionary functions would not extend to all acts involving choice or judgment, but did protect the discretion of a governmental executive or administrator to act according to his or her best judgment a concept the *Peavler* court noted had "substantial historical ancestry in American law."¹⁰⁰

3. *Policies Underlying Governmental Immunity.*—After thoroughly examining the historical background of governmental immunity, the *Peavler* court next scrutinized the policy foundations of governmental immunity.¹⁰¹ The court noted that although "the early purposes of governmental immunity largely have been eliminated," governmental immunity had continuing validity resting on three foundations: (1) a separation of powers basis, relying on "the fundamental idea that certain kinds of executive branch decisions should not be subject to judicial review," (2) prevention of "judicial second-guessing or harassment by the actual or potential threat of liability" which could inhibit "the effective and efficient performance of governmental duties," and (3) the

94. *Id.*

95. 28 U.S.C. § 1346(b) (1982).

96. *Id.* § 2680(a).

97. *Indian Towing Co. v. United States*, 350 U.S. 61, 65 (1955).

98. *Id.*

99. *Dalehite*, 346 U.S. 15, 42 (1953).

100. *Peavler*, 528 N.E.2d at 44.

101. *Id.*

failure of traditional tort standards of negligence to "provide an adequate basis for evaluating certain governmental decisions."¹⁰² The court concluded the planning/operational analysis provided the best framework for Indiana governmental liability law and adopted the this analysis to replace Indiana's discretionary/ministerial analysis. As to the scope of liability under the new standard, the court noted:

Immunity for discretionary functions, however, does not protect all mistakes of judgment. The discretionary function exception insulates only those significant policy and political decisions which cannot be assessed by customary torts standards. In this sense, the word discretionary does not mean mere judgment or discernment. Rather, it refers to the exercise of political power which is held accountable only to the Constitution or the political process.¹⁰³

Under *Peavler*, therefore, a governmental entity retains immunity from liability for acts and omissions constituting the exercise of a judicial or legislative function, or if an executive action, involving the determination of fundamental government policy.¹⁰⁴

Peavler detailed practical application of the planning/operational analysis. This analysis "requires an inquiry into the nature of the governmental act and the decision-making process involved" with "the critical inquiry" being "not merely whether judgment was exercised but whether the nature of the judgment called for policy consideration":

Under the planning/operational dichotomy, the type of discretion which may be immunized from tort liability is generally that attributable to the essence of governing. Planning activities include acts or omissions in the exercise of a legislative, judicial, executive or planning function which involves formulation of basic policy decisions characterized by official judgment or discretion in weighing alternatives and choosing public policy. Government decisions about policy formation which involve assessment of competing priorities and a weighing of budgetary considerations or the allocation of scarce resources are also planning activities.

The distinction between planning and operational functions is a standard, rather than a precise rule. The focus must remain on the policy underlying governmental immunity. If the act is one committed to coordinate branches of the government in-

102. *Id.*

103. *Id.* at 45 (citations omitted).

104. *Id.*

volving policy decisions not reviewable under traditional tort standards of reasonableness, the government is immune from liability even if the act was performed negligently.¹⁰⁵

Indiana's ministerial/discretionary test previously defined discretionary in the negative: anything which was non-ministerial was "discretionary."¹⁰⁶ Such a test did not require an affirmative finding that the governmental action arose from the type of policy-making decision protected by governmental immunity, but operated instead by the process of elimination by removing ministerial acts from the more general category of discretionary immune acts.¹⁰⁷

Under *Peavler*, liability is the general rule and the exception for discretionary functions removes certain acts from the broader spectrum of liability.¹⁰⁸ Before immunity for exercising a "discretionary function" is proper, there must be "an affirmative finding that the governmental act is of the type intended to be protected by immunity."¹⁰⁹ Further, although determination of whether an act is discretionary remains a question of law for the court, *Peavler* provides that "discretionary immunity must be narrowly construed because it is an exception to the general rule of liability."¹¹⁰ *Peavler* places the burden of proof on the governmental entity seeking to establish immunity "that the challenged act or omission was a policy decision made by consciously balancing risks and benefits."¹¹¹

To further delineate the practical application of the planning/operational analysis, *Peavler* provided a thorough set of factors to be considered in deciding whether a governmental entity has succeeded in establishing immunity:

Factors which would, under most circumstances, point toward immunity, include:

1. The nature of the conduct—

- a) Whether the conduct has a regulatory objective;
- b) Whether the conduct involved the balancing of factors without reliance on a readily ascertainable rule or standard;
- c) Whether the conduct requires a judgment based on policy decisions;

105. *Id.* (citations omitted).

106. *Id.*

107. *Id.* at 45-46.

108. *Id.* at 46.

109. *Id.*

110. *Id.*

111. *Id.*

- d) Whether the decision involved adopting general principles or only applying them;
 - e) Whether the conduct involved establishment of plans, specifications and schedule; and
 - f) Whether the decision involved assessing priorities, weighing of budgetary considerations or allocation of resources.
2. The effect on governmental operations—
 - a) Whether the decision affects the feasibility or practicability of a government program; and
 - b) Whether liability will affect the effective administration of the function in question.
 3. The capacity of the court to evaluate the propriety of the government's action—

Whether tort standards offer an insufficient evaluation of the plaintiff's claim.¹¹²

These factors will assist both practitioners and governmental entities in gauging liability for various acts and conduct.

4. *Application to Presented Facts.*—Applying the planning/operational analysis to the facts presented in *Peavler*, the court noted:

Tort standards of reasonableness do not provide an adequate basis for evaluating the failure to erect a warning sign if that failure arises from an actual, affirmative policy decision. If the decision is based on professional judgment, however, rather than policy oriented decision-making, traditional tort standards for professional negligence afford a basis for evaluation. Thus, a county's considered decision to entrust placement of traffic control devices to a traffic engineer is not reviewable under tort standards, while the engineer's subsequent decisions as to warning signs are reviewable under tort standards of professional negligence.¹¹³

Because neither defending county presented evidence to show its decision regarding the warning signs was the result of a decision-making process, neither was entitled on the record before the court to judicial deference to a policy oriented decision-making judgment.¹¹⁴ Accordingly, the trial court in *Peavler* erred in instructing the jury that placement of warning signs was a discretionary function.¹¹⁵ The judgment of the *Hout* trial court denying summary judgment was affirmed, as the county had failed

112. *Id.*

113. *Id.* at 47.

114. *Id.* at 48.

115. *Id.*

to prove the failure to place the warning sign was within the discretionary function exception to ITCA.¹¹⁶

5. *The Peavler Dissenting Opinion.*—Justice Pivarnik dissent in *Peavler* supported retention of the traditional analysis. The dissent argued that Indiana statutes which allow municipalities to place warning signs¹¹⁷ are permissive rather than mandatory in nature, requiring a conclusion all traffic sign placement decisions are inherently discretionary in nature.¹¹⁸ Justice Pivarnik found the planning/operational test “no less confusing than the method presently used,” and a transgression of the “proper function of the Legislature as direct representatives of the people,” although the dissent admitted the discretionary/ministerial test “has been a difficult one to apply.”¹¹⁹ The dissent dramatized the majority’s holding, stating it would “virtually wipe out all governmental immunity” and require a governing body to be able to show that it had an affirmative hearing and made express and affirmative finding that signs were not necessary at “every point in every road and street in the state. . .”¹²⁰

6. *Peavler’s Effect on Municipal Liability Law.*—*Peavler* recognizes that immunity for discretionary functions could be an exception that swallowed the whole if applied to all acts involving any degree, no matter how small, of judgment. Because prior analytical frameworks have not proven efficient in consistently determining appropriate application of the discretionary function exception, *Peavler* appears to be a timely effort to adopt a more workable analysis. The planning-operation analysis is not a novel approach, but has been in use concerning federal claims for many years. The analysis may expand the potential liability of municipal entities, but remains consistent with the policy foundations of governmental immunity.

Justice Pivarnik’s dissent in *Peavler* was weakened by his failure to demonstrate how the present discretionary/ministerial test could be prospectively applied in a better manner. This omission is perhaps understandable given his view that traffic signal placement decisions are inherently discretionary, and the futility of repairing an analysis already rejected by the majority. In the absence, however, of a reasoned alternative to an admittedly difficult determination, “no less confusing” appears no less wrong.

The *Peavler* court defined a more workable and less confusing manner of determining whether a governmental entity should be immune under the “discretionary” function exception to the ITCA. The majority de-

116. *Id.*

117. See IND. CODE § 9-4-1-1.

118. *Peavler*, 528 N.E.2d at 51.

119. *Id.*

120. *Id.*

cision is thoroughly reasoned and practical applications of the new analysis are addressed in detail. The specific *Peavler* guidelines will encourage governmental entities to well document those decisions which are made through a policy oriented decision making process. Given the increasing frequency with which the state and its municipalities are named as parties or nonparties at fault in automobile accidents, *Peavler* is likely to be quickly and widely applied.¹²¹

B. "Substantial Compliance" Extends to Service of Tort Claim Notice

The Indiana Supreme Court extended "substantial compliance" principles to service of a notice of tort claim under ITCA in *Indiana State Highway Commission v. Morris*.¹²² *Morris* involved an automobile accident that occurred on a one-lane state highway bridge. After a judgment against the State, the Indiana Court of Appeals reversed because plaintiffs had not served a tort claim notice on the Indiana Attorney General.¹²³

The accident at issue occurred October 14, 1978. Plaintiffs mailed a notice of a tort claim to the Indiana Highway Commission, which received it February 6, 1979. The same day, the Highway Commission copied the notice and forwarded the copy to the Indiana Attorney General, who received it February 7, 1979, within the required 180 day time period.

The Indiana Tort Claims Act provides that "a claim against the state is barred unless notice is filed with the Attorney General and the state agency involved within one hundred eighty (180) days after the loss occurs."¹²⁴ The state argued ITCA requirements were not met because plaintiffs did not serve the Indiana Attorney General directly, and that the doctrine of substantial compliance could not extend to remedy the error.¹²⁵ Plaintiffs argued that notice of a tort claim can be "filed" in accordance with the ITCA requirements by a third party, in this case by the Highway Commission.

Applying the language of the statute literally, the Indiana Supreme Court found ITCA simply requires that a notice be "filed" and does

121. Because a "non-party" under the comparative law act is "one who is or may be" liable to the plaintiff, immunity under the ITCA should prevent a governmental entity from being a "non-party" under the Act. See, *Huber v. Henley*, 656 F. Supp. 508 (S.D. Ind., clarified in *Huber v. Henley*, 669 F. Supp. 1474 (S.D. Ind. 1987); Rosiello & Talley, *A Survey of Indiana Tort Law*, 22 IND. L. REV. 503, 505-09 (1988).

122. 528 N.E.2d 468 (Ind. 1988).

123. 488 N.E.2d 713 (Ind. Ct. App. 1986).

124. IND. CODE § 34-4-16.5-6 (1988).

125. *Morris*, 528 N.E.2d at 470.

not designate who must file the notice.¹²⁶ Further, the court found the objectives of ITCA were satisfied because the Highway Commission and the Attorney General each received timely notice fully advising them that the plaintiffs were making a claim.¹²⁷ The court held "substantial compliance" with the statutory notice requirements is achieved when the general purpose of the notice requirement is satisfied.¹²⁸ The general purpose is fulfilled when officials of the governmental entity are informed with reasonable certainty of the accident and surrounding circumstances so that the political division has an opportunity to investigate, determine its possible liability, and prepare a defense.¹²⁹

Because the statutory objective was met, albeit by a diligent defendant, ITCA did not bar plaintiff's claims. The *Morris* plaintiffs fortuitously benefited from what appears to be a trend in Indiana decisions to allow claims against governmental entities to be decided on their merits, rather than on technicalities. This trend is consistent with traditional civil justice standards and the purposes of the Indiana Rule of Trial Procedure "to secure the just, speedy and inexpensive determination of every action"¹³⁰ and "to do substantial justice, lead to disposition on the merits, and avoid litigation of procedural points."¹³¹

C. Notice Filed By Registered Mail

The Indiana Court of Appeals addressed an important procedural question relating to timely filings of notice of a tort claim in *Wallis v. Marshall County Commissioners*.¹³² The issue presented was whether a

126. *Id.* at 470.

127. *Id.* at 471.

128. *Id.*

129. *Id.*

130. IND. R. TR. P. 1.

131. IND. R. TR. P. 8(F). The *Morris* court also decided that a jury need not be instructed on the statutory limits of liability, thus allowing a jury to return a verdict in excess of the statutory limits. This issue was significant in *Morris* because plaintiffs argued the judicial set off for settlement with other entities should occur from the amount of the verdict rather than from the maximum statutory amount. 528 N.E.2d at 473-74.

132. 531 N.E.2d 1223 (Ind. Ct. App. 1988). After this article was written, but shortly before publication, the Indiana Supreme Court granted transfer in *Wallis v. Marshall County Commissioners*, 546 N.E.2d 843 (Ind. 1989) and unanimously reversed the court of appeals on the timeliness of the tort claim notice. The *Wallis* decision was heavily influenced by *Collier v. Prater*, 544 N.E.2d 497 (Ind. 1989), another decision published after the survey period. *Collier* found the ITCA is to be "strictly construed against limitations on a claimant's right to bring suit," a rule that appears to overrule inconsistent portions of *Burggrabe v. Board of Public Works*, 469 N.E.2d 1233 (Ind. Ct. App. 1984), relied on by the court of appeals in *Wallis*.

Because the Indiana Supreme Court found *Collier* to mandate strict construction

notice mailed by certified mail on the 180th day after the accident was timely, or barred because it was not received by the governmental entity until the 181st day after the accident.

The ITCA requires that a notice of tort claim be "filed" within 180 days after the loss occurs.¹³³ A different section of ITCA requires the notice "must be in writing and must be delivered in person or by registered or certified mail."¹³⁴ Accordingly, the court found plaintiff's claim barred.

The *Wallis* holding is surprising in light of *Peavler, Morris*, and the Indiana Supreme Court decision in *State Board of Tax Commissioners v. LeSea Broadcasting Corp.*¹³⁵

In *LeSea Broadcasting*, the Indiana Supreme Court adopted, in its entirety a decision of the Indiana Tax Court¹³⁶ holding that a statute silent as to the method of filing allowed filing by registered or certified mail, consistent with the Indiana Rules of Trial Procedure 5(E).

The tax court noted that "this construction is the one which most attorneys give to such provisions especially in those situations where a court action is involved and the matter is not fully within the administrative process.¹³⁷ Although Judge Fisher's decision was decided on the basis of Indiana Code section 6-1.1-15-5(c)(1) which sets time limits for certain tax filings, the tax court's reasoning is applicable to other statutes silent as to the method of filing.

The adoption by the supreme court of the tax court's decision, in its entirety, gives further credence to a general applicability of the *LeSea Broadcasting* reasoning.¹³⁸ The Indiana Supreme Court's opinion expresses its "total agreement" with the tax court opinion, which was "therefore approved and adopted in its entirety for the guidance of the bench and the Bar and administrative offices of this state."¹³⁹ Such a broad based endorsement by the Indiana Supreme Court is inconsistent with the

against limitations on a claim, the delivery issues considered in the text of this article did not require resolution.

In *Boger v. Lake County Commissioners*, 547 N.E.2d 257 (Ind. 1989), the Indiana Supreme Court also resolved a similar ITCA issue after the survey period. *Boger* held a tort claim notice timely under Trial Rule 6(A)3 where it was filed after the 180 day notice period expired. The court held where the notice period expires on a legal holiday or day when the filing office is closed, the claimant has until the next day the office is open in which to file under Trial Rules 6(A)3 and 6(A)4. *Id.* at 258.

133. IND. CODE § 34-4-16.5-7(a) (1988).

134. *Id.* § 34-4-16.5-11.

135. 511 N.E.2d 1009 (Ind. 1987). *See supra* note 132.

136. 512 N.E.2d 506 (Ind. Tx. Ct. 1987).

137. *Id.* at 509.

138. *LeSea Broadcasting*, 511 N.E.2d at 1013.

139. *Id.*

narrow interpretation of *LeSea Broadcasting* by *Wallis*, which distinguished *LeSea Broadcasting* as limited to the tax appeal notice statute.

Wallis appears founded on a prior decision of the Indiana Court of Appeals holding that the ITCA notice requirement must be "strictly construed."¹⁴⁰ *Wallis* failed to consider either the effect of *Morris* or *Peavler*, decided by the Indiana Supreme Court two months prior to *Wallis*. Both *Morris* and *Peavler* construe ITCA in a manner consistent with substantial justice and litigation on the merits. After *Morris*, one must conclude that ITCA is not strictly construed as to the notice filing requirement generally. *Morris*, after all, involved notice that was never served on the Attorney General by the plaintiffs, but which found its way to the Attorney General fortuitously. *Morris* allowed the claim by applying "substantial compliance" principles to the notice filing requirement,¹⁴¹ the same provision at issue in *Wallis*. Given *Morris* and the *LeSea Broadcasting* decisions, *Wallis* sharply cuts against the grain of recent Indiana Supreme Court decisions favoring resolution of such actions on their merits.

Further, *Wallis'* reliance on the "delivery" provision of ITCA does not provide a convincing rationale as to why filing by certified or registered mailing is not consistent with even a strict construction of ITCA notice requirements.¹⁴² ITCA requires that filing, rather than delivery, must occur prior to the expiration of the 180-day time period. ITCA does not state the validity of filing is preconditioned on delivery or that delivery must occur within the required time. Rather, the ITCA provision dealing with "delivery," relied upon so heavily in *Wallis*, provides notice should "be delivered *in person or by registered or certified mail*."¹⁴³ A plain reading of this statute supports the conclusion delivery can be made in person or, alternatively, by registered or certified mail. Basing an inference of a receipt requirement for filing on this provision appears tenuous at best.¹⁴⁴

Even if ITCA required "delivery" within the 180 day period, ITCA does not mandate a conclusion that delivery requires actual receipt within that time period. Delivery has been interpreted frequently in Indiana

140. *Burggrabe v. Board of Public Works*, 469 N.E.2d 1233, 1235 (Ind. App., *transfer denied* (1984) (Even *Burggrabe*, however, permitted delivery by ordinary mail, a method not explicitly permitted in the ITCA)).

141. *Morris*, 528 N.E.2d at 470-71.

142. The *Wallis* court reasoned that timely filing requires timely delivery, and delivery requires receipt, therefore, filing receipt. Both premises underlying this conclusion have inescapable weaknesses.

143. IND. CODE § 34-4-16.5-11 (1988) (emphasis added).

144. *Wallis* noted all parties there agreed "delivery" meant the proper officials must actually receive the notice. Accordingly, *Wallis* does not address or further analyze delivery requirements. 531 N.E.2d 1223 (Ind. Ct. App. 1988).

and other states to be complete when an item is given to a third party to be passed on to the ultimate recipient. This principle has been applied in many jurisdictions in important substantive contexts, such as contracts,¹⁴⁵ deed¹⁴⁶ or gift delivery,¹⁴⁷ and even in some criminal contexts.¹⁴⁸ To apply a stricter standard in a procedural setting, particularly where the purpose of the statute is to fulfill a notice requirement, confounds even the strictest of constructions.¹⁴⁹

Wallis concluded that filing by registered or certified mail was not actual compliance with ITCA. Having decided actual compliance was absent, substantial compliance as interpreted by *Morris* should have been addressed. *Wallis* is further weakened by its failure to analyze in detail the delivery requirement of the ITCA.

Wallis is likely to remain controversial and subject to challenge¹⁵⁰ until a definitive ruling on this issue by the Indiana Supreme Court.¹⁵¹

III. PRE-JUDGMENT INTEREST

The Indiana General Assembly has enacted a new statute on the topic of prejudgment interest in tort actions which may extend the

145. See IND. CODE § 26-1-1-201(14) (1988) ("Delivery . . . means voluntary transfer of possession."); see also IND. CODE § 26-1-1-201(27) (1988) ("A person 'notifies' or 'gives' a notice . . . by taking such steps as may be reasonably required to inform the other in ordinary course whether or not the other actually comes to know of it.")

146. Vaughan v. Godman, 94 Ind. 191, 195 (1883) (A deed "may be delivered without being actually handed over. It may be delivered without being put into the hands of the grantee, as by leaving it with a third person."); see also Nye v. Lowry, 82 Ind. 316 (1882); Dermond v. Dermond, 10 Ind. 191 (1858).

147. A charitable gift is consummated when the property is delivered "to a third party, with the intent on the part of the donor that the latter's dominion over it has thereby ceased." Richards v. Wilson, 185 Ind. 335, 385 (1916).

148. In the criminal context, delivery has been found where a controlled substance was given to a courier service in furtherance of an attempt to send the drugs to a third party. State v. Gentry, 462 So. 2d 624, 627-28 (La. 1985).

149. Because ITCA focuses on filing, cases involving statutes or contracts which explicitly require receipt of written notice are distinguishable because the ITCA does not have any explicit receipt requirement.

150. *Wallis* states its holding on this issue is in accord with the rule applied in other jurisdictions. *Wallis*, 531 N.E.2d at 1225; see Annotation, *Deposit in Mail of Notice of Claim Required as Condition of Action Against, or Liability of Governmental Body, As a Giving of Notice Within Required Period*, 175 A.L.R. 299 (1948). Many of the cases addressing this are very old and consider issues, facts or statutory requirements that are distinguishable. Some more recent cases have held filing can be complete on proper mailing. See Gurney v. Rapid City, 50 N.W.2d 360 (S.D. 1951); Montez v. Metropolitan Transp. Auth., 43 A.D.2d 224, 350 N.Y.S.2d 665 (1974); Desroches v. Caron, 11 Misc. 2d 838, 174 N.Y.S.2d 627 (1958); but see Gates v. State 128 N.Y. 221, 28 N.E. 373 (1891).

151. The Indiana Supreme Court unanimously reversed *Wallis* shortly before publication of this article. See *supra* note 132.

circumstances under which a plaintiff can claim prejudgment interest.¹⁵² The statute "applies to any civil action arising out of tortious conduct" which accrues on or after July 1, 1988.¹⁵³ Under traditional standards, prejudgment interest was recoverable only where the amounts at issue are liquidated or could be determined with certainty.¹⁵⁴ Prejudgment interest has not traditionally been recoverable in actions requiring the jury to exercise its discretion in awarding damages such as pain, suffering or other damages not measurable by fixed standards of value.¹⁵⁵ Under the new statute, the traditional limitations on recovery of prejudgment interest are not addressed and are apparently abandoned.

Although the act does not apply to a claim against the patient's compensation fund,¹⁵⁶ governmental entities,¹⁵⁷ or pre-judgment interest on punitive damages,¹⁵⁸ virtually all other tort actions are included.¹⁵⁹ An award of prejudgment interest, however, is discretionary,¹⁶⁰ and subject to certain limits.¹⁶¹ The Act does not apply if within nine months after a claim is filed in court, or a longer period determined by the court to be necessary upon a showing of good cause, one or more of the defendants makes a written offer of settlement to the party who later received a judgment, and the amount of the offer was at least two-thirds of the amount of the ultimate judgment award.¹⁶²

Conversely, the Act also does not apply if within one year after a claim is filed in court, or a longer period determined by the court to be necessary upon a showing of good cause, the party who filed the claim fails to make a written offer of settlement to the party or parties against whom the claim is filed, or the amount of the offer exceeds one and one-third of the amount of the judgment ultimately awarded.¹⁶³

The statute encourages early and realistic settlement evaluation, and penalizes delays. Plaintiff can lose the potential benefit of the statute

152. Pub. L. No. 149-1988, 1988 Ind. Acts 1858 codified at IND. CODE ANN. § 34-4-37-1 (Burns Supp. 1989).

153. IND. CODE ANN. § 34-4-37-3 (Burns Supp. 1989).

154. Rauser v. LTV Electrosystems, Inc., 437 F.2d 800 (7th Cir. 1971); Indiana Indus., Inc. v. Wedge Prod., Inc., 430 N.E.2d 419, 427 (Ind. Ct. App. 1982).

155. New York, Chicago & St. L. Ry. v. Roper, 176 Ind. 497, 96 N.E. 468 (1911).

156. IND. CODE ANN. § 34-7-37-4 (Burns Supp. 1989).

157. *Id.* § 34-4-37-6 (exempting liability on behalf of the state or any political subdivision as those terms are defined in IND. CODE § 34-4-16.5-2).

158. *Id.* § 34-4-37-5.

159. *Id.* § 34-4-37-3.

160. *Id.* § 34-4-37-9.

161. *Id.* §§ 34-4-37-10, -11.

162. *Id.* § 34-4-37-7. The terms of the offer must include payment within 60 days after the offer is accepted.

163. *Id.* § 34-4-37-8. The terms of the offer must provide for payment of the settlement offer within 60 days after the offer is accepted.

by either failing to present a settlement demand that bears a close relationship to the judgment actually obtained, or by failing to make a timely demand.¹⁶⁴ Defendant, likewise, can prevent application of the statute by making a timely settlement offer that bears a close relationship to the judgment actually obtained.¹⁶⁵ The statute thus represents an admirable effort to encourage quick and accurate settlement evaluations and forthright settlement discussions.

The statute limits prejudgment interest to a period not to exceed 48 months, and the court can exclude any period of delay caused by the party seeking prejudgment interest.¹⁶⁶ The prejudgment interest is to be awarded at a simple interest rate determined by the court in an amount not less than 6% per year and not more than ten percent per year.¹⁶⁷

IV. STATUTE OF LIMITATIONS FOR INJURIES TO PERSON OR CHARACTER

In *Burks v. Rushmore*,¹⁶⁸ the Indiana Supreme Court applied a discovery rule to a statute of limitations issue in a defamation action. More importantly, the court signaled its philosophical agreement with application of a discovery rule for all tort actions governed by the injury to person or property two year statute of limitations.¹⁶⁹ In this respect, *Burks* is an important decision and an important interpretation of *Barnes v. A.H. Robins Co.*,¹⁷⁰ which applied a discovery rule to determine tort action accrual in the occupational disease context.

Burks was an employee of Indiana Bell Telephone Company during 1981. On November 9, 1981, a co-employee Rushmore wrote and circulated an alleged defamatory memorandum and attachments relating to Burks, who was then on disability leave from his job. Burks first learned of the memorandum on November 3, 1982. Indiana Bell refused a request by Burks to give him a copy of the memorandum on December 3, 1982. Burks filed a complaint for defamation on November 1, 1984, and did not obtain a copy of the memorandum until May 10, 1985, in the course of the ensuing litigation.

Rushmore contended Burks' action was barred by the applicable statute of limitations, arguing a cause of action for defamation accrues upon the publication of the allegedly defamatory material, rather than

164. *Id.*

165. *Id.* § 34-4-37-7.

166. *Id.* § 34-4-37-10.

167. *Id.* § 34-4-37-11.

168. 534 N.E.2d 1101 (Ind. 1989).

169. *Id.* at 1104-05.

170. 476 N.E.2d 84 (Ind. 1985).

discovery by the person allegedly defamed of the publication.¹⁷¹ Prior decisions of the Indiana Court of Appeals supported this position. On appeal, however, the *Burks* court held a defamation action accrues on discovery of the defamation, creating a conflict between the *Burks* decision and the prior opinions of the Indiana Court of Appeals in *Chacharis v. Fadell*¹⁷² and *Kaletha v. Bortz Elevator Co.*¹⁷³ The Indiana Supreme Court granted transfer to address the conflict in these decisions.

Both *Chacharis* and *Kaletha*, which supported Rushmore's argument that a cause of action for defamation accrued from publication, regardless of whether the allegedly defamed person knew of the publication, were decided prior to *Barnes v. A.H. Robins Co.*¹⁷⁴ In *Burks*, the Indiana Supreme Court declared any "inconsistency"¹⁷⁵ in its decisions about when a tort action accrues was resolved by *Barnes*, where the court declared that: "[t]he rule in Indiana has been generally understood that a cause of action accrues when the resultant damage of a negligent act is ascertainable or by due diligence could be ascertained. . . ."¹⁷⁶

In *Barnes*, however, the court explicitly declined to extend its holding to tort actions other than the occupational disease action before it.¹⁷⁷ The *Burks* court, however, stated that *Barnes* provides the proper basis for resolution, and that the statute of limitations generally applied to personal injury and tort actions "commenced to run when resultant damage was ascertained or ascertainable by due diligence."¹⁷⁸ The court noted the statute of limitations defense would still be available to Rushmore if Burks had failed to commence the action within two years after actionable harm could have been reasonably ascertained.¹⁷⁹ Burks' ability to ascertain damage could not be determined solely by the date of the alleged publication, but required evaluation of the nature of circumstances of the information known or reasonably discoverably by Burks beginning at the initial point of the claimed harm.¹⁸⁰ Because application of the statute of limitations appeared to rest upon disputed questions of fact, the court remanded for further determination.¹⁸¹

171. *Burks*, 534 N.E.2d at 1103.

172. 438 N.E.2d 1032 (Ind. Ct. App. 1982).

173. 178 Ind. App. 654, 383 N.E.2d 1071 (1978).

174. 476 N.E.2d 84 (Ind. 1985).

175. *Burks*, 534 N.E.2d at 1104.

176. 476 N.E.2d at 86.

177. *Id.* at 87.

178. 534 N.E.2d at 1104.

179. *Id.*

180. *Id.*

181. *Id.* at 1105.

V. CHILD'S CLAIM FOR LOSS OF CONSORTIUM BASED ON INJURY TO PARENT

In *Dearborn Fabricating and Engineering Corp. v. Wickham*,¹⁸² the Indiana Court of Appeals recognized a cause of action by a child for loss of consortium based on injury to a parent. After the children of William D. Wickham asserted a claim based for personal injuries to their father, Dearborn filed a motion to dismiss for failure to state a claim for relief. The trial court granted the motion in part, but denied the motion as to claims by the children for loss of services, society and companionship.¹⁸³ Dearborn appealed, raising the issue of whether minor children should be permitted to assert a claim for loss of parental consortium when the parent is negligently injured by a third person.

This was a case of first impression in Indiana. Of the thirty-three jurisdictions which have addressed this issue, twenty-six have refused to recognize the cause of action.¹⁸⁴ Seven states, however, have recognized the cause since 1980.¹⁸⁵

The *Dearborn* court recognized that the following arguments have been advanced by courts declining to recognize the cause of action: (1) damages are speculative due to the intangible nature of the loss; (2) double recovery may occur through an overlap between a parent's and a child's damages; (3) recognition could lead to a multiplicity of lawsuits and protracted litigation; (4) insurance premiums will increase by extending liability; and (5) the judiciary should defer to the legislature for consideration of this policy question.¹⁸⁶ The court of appeals disagreed with these arguments and that held a minor child has an independent cause of action for loss of parental consortium when the parent is negligently injured by a third person.¹⁸⁷

182. 532 N.E.2d 16 (Ind. Ct. App. 1988), *petition for transfer pending*.

183. *Id.* The children originally claimed relief based on "the loss of the support, services, society and companionship of their father." The trial court, in granting Dearborn's motion, struck the word "support" from the complaint. *Id.*

184. See *Hibpshman v. Prudhoe Bay Supply, Inc.*, 734 P.2d 991, 991 n.4 (Alaska 1987) for a list of jurisdictions refusing to recognize the cause of action.

185. See *Hibpshman*, 734 P.2d 991 (Alaska 1987); *Weitl v. Moes*, 311 N.W.2d 259 (Iowa 1981), *overruled by Audubon-Exira v. Illinois Central Gulf R.R.*, 335 N.W.2d 148 (Iowa 1983) (no independent action recognized because loss of parental consortium is an element of damages and the statute for wrongful or negligent injury or death); *Ferriter v. Daniel O'Connell's Sons, Inc.*, 381 Mass. 507, 413 N.E.2d 690 (1980); *Berger v. Weber*, 411 Mich. 1, 303 N.W.2d 424 (1981); *Hay v. Medical Center Hosp.*, 145 Vt. 533, 496 A.2d 939 (1985); *Ueland v. Reynolds Metals Co.*, 103 Wash. 2d 131, 691 P.2d 190 (1984); *Theama v. City of Kenosha*, 117 Wis. 2d 508, 344 N.W.2d 513 (1984).

186. *Dearborn*, 532 N.E.2d at 17.

187. *Id.*

Addressing the concerns advanced by courts declining to recognize the cause of action, the court reasoned that damages for loss of parental consortium are no more speculative or difficult to assess than claims currently recognized for loss of spousal consortium or for pain and suffering generally.¹⁸⁸ The court further reasoned that concerns about a potential for double recovery can be eliminated by recognizing that the child's damages are limited primarily to an emotional suffering award in most cases.¹⁸⁹ Concerns as to multiplicity of claims and protracted litigation were addressed by the court with the suggestion that such protracted litigation can be minimized by requiring joinder of the minor's consortium claim with the injured parent's claim wherever feasible.¹⁹⁰

The court rejected the argument that insurance premiums would increase, reasoning that the harm this would cause was outweighed by the benefits of providing for the needs of children in the time of loss.¹⁹¹ Concerns that the court should defer to the legislature were found inappropriate because "causes of action for loss of consortium have historically been allowed or denied by common law."¹⁹²

Having addressed the concerns advanced in courts declining to recognize the cause of action, the court then compared a minor child's claim for loss of parental consortium to damages recoverable under Indiana's wrongful death statute, noting "as long as the injury is severe enough to deprive the child of his parent's companionship and guidance, the parent should not have to die for the child to gain relief."¹⁹³

A petition for transfer in *Dearborn* has been argued to the Indiana Supreme Court and is pending at the time of this Article. If affirmed by the Indiana Supreme Court, *Dearborn* will be a significant change to Indiana's personal injury tort law.

Until a definitive ruling by the Indiana Supreme Court, however, practitioners are faced with problems in the settlement of actions where the injured party has minor children. Defendants seeking to settle such claims are well advised to settle any potential claims by the minor children and to seek probate approval of the settlement so that the validity of the settlement cannot be challenged.¹⁹⁴ *Dearborn* suggests,

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.* (following *Berger v. Weber*, 411 Mich. 1, 303 N.W.2d 424, 426 (1981)).

192. *Dearborn*, 532 N.E.2d at 17.

193. *Id.* at 18.

194. See IND. CODE ANN. § 29-3-9-7(b) (Burns Supp. 1989) (requiring approval by a court for settlement of claim of a minor), and IND. CODE ANN. § 29-3-3-1 (Burns Supp. 1989) (allowing certain payments under \$3,500 to be made to the natural guardian of a child without the appointment of a guardian *ad litem*).

however, that if claims by minor children have not been consolidated with the parents' action, they may be barred for the failure of joinder.¹⁹⁵ Considerable uncertainty exists as to application of *Dearborn*, uncertainty that will hopefully be resolved by the Indiana Supreme Court. Given the broad potential application of *Dearborn*, the Indiana Supreme Court decision in this action is likely to be closely reviewed and quickly applied.

VI. ATTORNEY LIABILITY/NEGLIGENT PERFORMANCE OF CONTRACTUAL DUTIES

In *Walker v. Lawson*,¹⁹⁶ the Indiana Supreme Court held that an attorney who drafted a will could be sued by an intended beneficiary under the will, despite the lack of privity between the attorney and the beneficiary. Under older cases, a person not a party to the contract could not sue for negligent performance of contracted duties.¹⁹⁷ Courts in more recent years have eroded that concept, particularly as to professional services contracts, by allowing a negligence action based on failure to fulfill contractual duties where the claimant is a third party known to have been the object for whom the contractual duties were carried out, or for whom the contractual duties were to benefit.¹⁹⁸ On this point, the Indiana Supreme Court affirmed the Indiana Court of Appeals, although ultimately reversing the Indiana Court of Appeals decision on other grounds.

Walker conforms Indiana law to that of an increasing number of jurisdictions which have held a beneficiary may sue the attorney who prepared a will based on the attorney's negligence.¹⁹⁹ Indiana has recognized in other contexts that one rendering professional services may be liable to a third party beneficiary.²⁰⁰ *Walker* thus does not represent a substantial extension of existing law.

Walker was quickly interpreted by the Indiana Court of Appeals in *Hermann v. Frey*²⁰¹ where the court of appeals addressed the general applicability of *Walker* to other third party contexts. In *Hermann* the court stated that "[i]n general terms, a third party beneficiary contract

195. *Dearborn*, 532 N.E.2d at 17.

196. 526 N.E.2d 968 (Ind. 1988).

197. See, e.g., *National Sav. Bank v. Ward*, 100 U.S. 195 (1880) ("where there is neither fraud nor collusion nor privity of contract, the party will not be held liable, unless the act is one eminently dangerous to the lives of others").

198. See *Walker v. Lawson*, 514 N.E.2d 629, 632-633 (Ind. Ct. App. 1987), *vacated on other grounds*, 526 N.E.2d 968 (Ind. 1988).

199. See Annotation, *Attorney's Liability to One Other Than His Immediate Client, for Consequences of Negligence in Carrying Out Legal Duties*, 45 A.L.R. 3d 1181 (1972).

200. See *Essex v. Ryan*, 446 N.E.2d 368 (Ind. Ct. App. 1983).

201. 537 N.E.2d 529 (Ind. Ct. App. 1989).

arises when two parties enter into an agreement with the intent to confer a benefit on a third party, allowing a third party to sue on the contract despite the lack of privity.²⁰²

Hermann had retained Frey to represent the estate of her late husband for the purpose of bringing a medical malpractice action against the hospital and two doctors. Frey opened an estate in the probate court, appointing Hermann administratrix of the estate. A complaint was filed with the Indiana Insurance Commissioner, and a medical review panel determined one of the physicians had not been negligent. Frey later filed suit against the other health care providers and a subsequent trial resulted in a verdict for the defendants.²⁰³

Hermann thereafter filed a malpractice action against Frey, alleging negligence in his decision not to joint the physician exonerated by the Medical Review Panel. Hermann filed the action in her individual capacity, rather than as administratrix of the estate. Frey filed a motion for summary judgment claiming that Hermann could not file an action against him in her individual capacity because the estate was his client not Hermann individually.²⁰⁴ The court of appeals found that Hermann met the qualifications for a known third party beneficiary because she has her husband's only surviving heir, she had retained Frey to represent her husband's estate, and had been entitled to Frey's professional advice and counsel while prosecuting the estate's medical malpractice action as its administratrix.²⁰⁵

Both *Hermann* and *Walker* extend professional liability to the known third party beneficiaries of legal services. In both actions, a close relationship existed between the services and the benefit to the known third party. This element is important, and it may serve to limit claims by tangentially or remotely benefited third parties. Requiring a close relationship between the services rendered and the known third party could serve to limit the endless assertions of fault possible when comparative fault is extended to the performance of professional services.

VII. CONCLUSION

Significant changes occurred in Indiana tort law during the survey period. Among those changes, interpretation of the Comparative Fault Act continues to be the most widely applied decisions of the Indiana courts. Given the relative infancy of Indiana's comparative fault law, each new decision has potentially long lasting significance.

202. *Id.* at 531.

203. *Id.* at 530.

204. *Id.* at 530-31.

205. *Id.* at 531.

Changes in governmental liability law made during the survey period also promise to be of enduring significance. *Peavler* adopts a new analysis applicable to whether state and local governmental entities are exempt from liability under the ITCA. *Morris* extends substantial compliance analysis to service of a tort claim notice under ITCA, and marks a pattern toward construction of the ITCA in a manner consistent with litigation on the merits. Despite *Morris*, *Wallis* demonstrates the Indiana Court of Appeals still applies strict construction to some portions of the ITCA.

Indiana's new statute on prejudgment interest in tort actions, with its delay penalty provisions, promises to promote prompt settlement evaluation. The statute also rewards accurate estimations of liability, by preventing an award of prejudgment interest where settlement negotiations by the party seeking the award have not borne a close relationship to the judgment obtained.

Burks presents a significant interpretation of statute of limitations law, clarifying *Barnes v. A.H. Robins, Co.*²⁰⁶ as to the proper scope of its application.

Dearborn also presents an important change in Indiana tort law, recognizing a right of action by a minor to sue for loss of parental consortium. *Dearborn* will strongly impact Indiana personal injury practice if affirmed by the Indiana Supreme Court.

In addition to the changes described above, the Indiana Supreme Court clarified Indiana law regarding liability to a known third party beneficiary of professional services. The full contours of this liability have yet to be defined, but a close relationship of the services to the known third party beneficiary appears to be an important factor in these cases.

Many of the decisions discussed in this Article mark important changes in Indiana tort law. The survey period was marked by significant activity across many unrelated tort areas and by changes originating in both the legislature and courts. These changes are likely to receive further scrutiny in coming years as their interpretation and application are addressed.

206. 476 N.E.2d 84 (Ind. 1985).

Survey of Recent Developments in Indiana Products Liability Law

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I. INTRODUCTION

This Article surveys state and federal cases that affected or discussed Indiana's products liability law which were decided between July 1988 and September 1989. This Article discusses Indiana Supreme Court¹ and Indiana Court of Appeals decisions² that have applied Indiana law. In addition, this Article discusses recent Indiana legislation that may significantly affect asbestos related products liability litigation.³

II. THE CASES

A. The Rights of Bystanders Under the Product Liability Acts

1. The Relevant Statutory Provisions.—The Indiana Product Liability Act (the "Act") was originally passed in 1978⁴ and amended in 1983.⁵ The Act contains a definition of "user or consumer,"⁶ which

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1. *Covalt v. Carey Canada, Inc.*, 543 N.E.2d 382 (Ind. 1989); *State Farm Fire & Casualty Co. v. Structo Div., King Seeley Thermos Co.*, 540 N.E.2d 597 (Ind. 1989).

2. *Jackson v. Warrum*, 535 N.E.2d 1207 (Ind. Ct. App. 1989); *General Elec. Co. v. Drake*, 535 N.E.2d 156 (Ind. Ct. App. 1989); *Masterman v. Veldman's Equip., Inc.*, 530 N.E.2d 312 (Ind. Ct. App. 1988); *State Farm Fire & Casualty Co. v. Structo Div., King Seeley Thermos Co.*, 530 N.E.2d 116 (Ind. Ct. App. 1988), *vacated*, 540 N.E.2d 597 (Ind. 1989); *Jarrell v. Monsanto Co.*, 528 N.E.2d 1158 (Ind. Ct. App. 1988).

3. Act effective July 1, 1989, Pub. L. No. 217-1989 § 4, 1989 Ind. Acts 1603 (codified at IND. CODE ANN. § 33-1-1.5-5.5 (West Supp. 1989)).

4. Indiana Products Liability Act, Pub. L. No. 141-1978, § 28, 1978 Ind. Acts 1308 (codified at IND. CODE § 33-1-1.5-1 to -8 (1988)).

5. Indiana Product Liability Act, Pub. L. No. 297-1983, 1983 Ind. Acts 1814.

6. IND. CODE § 33-1-1.5-2 ().

terms are used in defining the scope of liability for damages caused by a defective product.⁷

The definition of "user or consumer" in the original version of the Act was as follows: "User or consumer shall include: a purchaser; any individual who uses or consumes the product; or any other person who, while acting for or on behalf of the injured party, was in possession or control of the product in question."⁸ Under this language, there was a question as to whether an injured bystander, who had no connection with the purchase or use of the product, could qualify as a "user or consumer" entitled to recover under the Act. The issue was especially acute because the original version of the Act encompassed all theories of product liability other than breach of warranty.⁹

In 1983, an explicit bystander provision was added to the definition of "user or consumer":

"User or consumer" means a purchaser, any individual who uses or consumes the product, or any other person who, while acting for or on behalf of the injured party, was in possession and control of the product in question, *or any bystander injured by the product who would reasonably be expected to be in the vicinity of the product during its reasonably expected use.*¹⁰

During the survey period, the Indiana courts addressed two issues concerning bystanders: (1) the scope of the definition of that term under the 1983 amendments to the Act; (2) whether the 1978 version of the Act, notwithstanding its lack of any express reference to bystanders, implicitly included bystanders within the scope of protection afforded by the Act.

2. *The Meaning of "Bystanders" in the 1983 Act.*—In *General Electric Co. v. Drake*,¹¹ the plaintiffs ("the Drakes") owned and leased

7. Under the current version of IND. CODE § 33-1-1.5-3(a): One who sells, leases, or otherwise puts into the stream of commerce any product in a defective condition unreasonably dangerous to *any user or consumer or to his property* is subject to liability for physical harm caused by that product *to the user or consumer or to his property* (Emphasis added.) The use of "user or consumer" was substantially the same in the 1978 version of this provision. See IND. CODE § 33-1-1.5-3(a) (1982).

8. IND. CODE § 33-1-1.5-2 (1982).

9. The section states: "This chapter shall govern all products liability actions, including those in which the theory of liability is negligence or strict liability in tort; provided, however, that this chapter does not apply to actions arising from or based upon any alleged breach of warranty." IND. CODE § 33-1-1.5-1 (1982).

In 1983, this provision was substantially restricted: "Except as provided in section 5 of this chapter, this chapter governs all actions in which the theory of liability is strict liability in tort." IND. CODE § 33-1-1.5-1 (1988).

10. IND. CODE § 33-1-1.5-2 (1988) (emphasis added).

11. 535 N.E.2d 156 (Ind. Ct. App. 1989).

real property damaged by a fire allegedly resulting from a defective extension cord purchased by their lessees. The Drakes sued the manufacturer of the cord (General Electric) and the seller (K-Mart) (collectively referred to as "G.E."). The Drakes' claim was limited to recovery for property damage sustained as a result of the fire. G.E. moved for summary judgment in the trial court arguing, among other things, that the Drakes were not "users" or "consumers" under the terms of the 1983 amendments to the Act. The trial court denied the motion.¹² On interlocutory appeal, the court of appeals affirmed on this issue.¹³

In the 1983 Act, "user or consumer" is defined as including "any bystander injured by the product who would reasonably be expected to be in the vicinity of the product during its reasonably expected use."¹⁴ G.E. argued that this definition imposed two conditions on a bystander's ability to recover: (a) the bystander must sustain *personal* injury¹⁵ as distinct from injury to property; and (b) that injury must have been sustained while the bystander was in the "vicinity" of the product at the time of the malfunction.¹⁶

G.E.'s first argument—that the legislature intended to restrict the class of bystanders to those who had suffered personal injury—was summarily dismissed by the court: "[T]he Act as a whole evinces a legislative intent to permit any 'user or consumer' to recover for physical harm to property without suggesting distinctions among the types of users or consumers or types of physical harm."¹⁷

The court also rejected G.E.'s second argument—that the injured bystander must have been in the "vicinity" of the product at the time of its malfunction. At the same time, it also rejected the Drakes' interpretation of the bystander provision, which would require only "a showing that [the plaintiffs'] property was within the vicinity of the product when the defective product was used."¹⁸ The court stated:

The parties' focus on the word "vicinity" has caused them to miss what we find to be critical, and what the trial court correctly recognized as creating a question of fact—the language of foreseeability. The qualification for recovery is not that the bystander or his property be present when the accident occurred, because clearly such an occurrence is not uncommon for plaintiffs gen-

12. *Id.* at 157.

13. *Id.* at 161.

14. IND. CODE § 33-1-1.5-2 (1988).

15. The 1983 Act defines "physical harm" as encompassing bodily injury as well as "sudden, major damage to property . . ." IND. CODE § 33-1-1.5-2 (1988).

16. *Drake*, 535 N.E.2d at 159.

17. *Id.*

18. *Id.* at 160.

erally; instead, it is that the bystander be one "who would reasonably be expected to be in the vicinity of the product during its reasonably expected use."¹⁹

The qualification for recovery was, therefore, whether the bystander was one "who would reasonably be expected to be in the vicinity of the product during its reasonably expected use. . . ."²⁰ Because a jury could reasonably find that a lessor would be expected to be within the vicinity of the product possessed by its lessee during the product's reasonably expected use, G.E. could not obtain summary judgment.²¹ Indeed, as a practical matter, the foreseeability test would appear to make the bystander issue a jury question in virtually every case. An interesting question that remains open under this rule is whether the plaintiff must prove foreseeability as to *himself* or simply as to the class of persons of which he is a member.

The court's interpretation is not without problems. The injury sustained by the lessors was to their property—not to their persons. The appropriate test, therefore, would seem to be whether it was reasonably foreseeable that property of the lessor could be damaged as a result of a defect in a product purchased by a lessee. The court's interpretation, however, requires that the plaintiff bystander must, himself, be one who would reasonably be expected to be in the vicinity of the product. This would appear to require that the lessor be exposed to *personal* injury in order to be compensated for injury to property.²² The rationale for such a requirement is not entirely clear.

3. *Bystanders Are Protected Under The 1978 Product Liability Act.*—In *State Farm Fire & Casualty Co. v. Structo Division, King Seeley Thermos Co.*,²³ the Indiana Supreme Court resolved a conflict among the courts of appeals and held that the 1978 Indiana Product Liability

19. *Id.*

20. *Id.*

21. *Id.* at 161.

22. *Id.* at 160 (stating that the jury issue is whether "the Drakes as . . . lessors could reasonably be expected to be within the vicinity of the product during its reasonably expected use"). In so holding, the court appears to have forgotten its own admonition that the Act as a whole evinces a legislative intent to permit a user or consumer "to recover for physical harm to property without suggesting distinctions among the types of users or consumers or types of physical harm." *Id.* at 159. Although the court never affirmatively stated the basis for this restriction—the notion of foreseeability could apply to the Drakes' property as easily as to the Drakes themselves—it appears to have been based upon the statutory definition that a "user or consumer" is "any bystander . . . who would reasonably be expected to be in the vicinity of the product. . . ." *Id.* (emphasis added).

23. 540 N.E.2d 597 (Ind. 1989).

Act²⁴—which, unlike the 1983 Act, makes no reference to bystanders—also recognizes the rights of reasonably foreseeable bystanders to recover for injuries caused by defective products. *State Farm* arose out of a fire at an apartment building, allegedly caused by a defective connection in a gas grill.²⁵ The plaintiff insurance companies sued for property damage suffered by their insureds, the owners and tenants of the apartments. The plaintiffs' sole theory of liability was strict products liability. The trial court entered a judgment on the evidence for the defendant. The court of appeals affirmed. The supreme court, however, vacated the court of appeals decision and reversed the trial court ruling.²⁶

The First District Court of Appeals had reasoned that, although liability to bystanders had been upheld before the Act, “courts had never considered bystanders to be in the class of users or consumers.”²⁷ The court of appeals considered itself bound by the terms of the Act: “[T]he letter of the Act is clear. It includes only users and consumers in the class of plaintiffs.”²⁸ Finally, the court of appeals rejected the argument that the 1983 amendment, clearly including bystanders in the definition of “user or consumer,” should be read as “evidence of the legislature’s intent at the original enactment of the statute.”²⁹

The Third District Court of Appeals reached the opposite conclusion in *Masterman v. Veldman’s Equipment, Inc.*³⁰ The plaintiffs in *Masterman* sued for personal injuries caused when a pickup truck struck their car. They claimed that their injuries were caused by a defective snowplow mount on the pickup truck that had been manufactured and sold by the defendants. In reversing summary judgment for the defendants, the court held that plaintiffs were “users or consumers” under the 1978 version of the Act.³¹ The court noted the pre-Act, common law authorities permitting bystanders to sue on a strict liability theory,³² and that “the product liability statute expressly declared that it was

24. Act approved March 10, 1978, Pub. L. 141-1978 § 28, 1978 Ind. Acts 1298, 1308-1310 (codified as amended at IND. CODE §§ 33-1-1.5-1 to -5 (1988)).

25. The facts are stated in the court of appeals opinion, *State Farm Fire & Casualty Co. v. Structo Div., King Seeley Thermos Co.*, 530 N.E.2d 116, 117 (Ind. Ct. App. 1988), *vacated*, 540 N.E.2d 597 (Ind. 1989).

26. *State Farm*, 540 N.E.2d at 598.

27. *State Farm*, 530 N.E.2d at 119.

28. *Id.*

29. *Id.*

30. 530 N.E.2d 312 (Ind. Ct. App. 1988). *Masterman* is also discussed *infra* notes 53-60 and accompanying text.

31. *Id.* at 316.

32. *Id.* (citing *Ayr-Way Stores v. Chitwood*, 261 Ind. 86, 300 N.E.2d 335 (1973); *Gilbert v. Stone City Constr. Co.*, 171 Ind. App. 418, 357 N.E.2d. 738 (1976); *Chrysler Corp. v. Alumbaugh*, 168 Ind. App. 363, 342 N.E.2d 908 (1976)).

intended to codify Indiana common law.”³³ The court stated: “[W]e have no difficulty, therefore, in concluding that reasonably foreseeable bystanders were entitled to protection under the statute prior to the 1983 amendments.”³⁴

The supreme court resolved this conflict in the *State Farm* decision³⁵ by endorsing the Third District’s holding in *Masterman*. In a terse opinion, the supreme court stated that “[b]ecause of the rule that legislative enactments in derogation of common law must be strictly construed and narrowly applied, we presume that the legislature is aware of the common law and does not intend to make any change therein beyond what it declares either in express terms or by unmistakable implication.”³⁶ The 1978 Act expressly purported to codify existing common law: it did not preclude the Act’s applicability to bystanders “by either express terms or unmistakable implication.”³⁷ Therefore, the 1978 legislature did not intend to abrogate the existing common law right of reasonably foreseeable bystanders to maintain a products liability action.³⁸

As authority on the meaning of the 1978 Act, *State Farm* will have little practical significance. However, the opinion indicated that the 1983 amendment to the “user or consumer” definition codified the earlier common law.³⁹ The supreme court characterized that law as “recogniz[ing] the right of reasonably foreseeable bystanders to recover for injuries caused by defective products.”⁴⁰ Thus, the *State Farm* analysis appears to support the interpretation of the 1983 amendment to the “user or consumer” definition in *General Electric*.

B. Second Collision Cases

1. *Indiana Courts Recognize the Second Collision Doctrine.*—The First and Third Districts of the court of appeals agreed that a “second collision” or “enhancement of injury” claim is recognized in Indiana. In *Jackson v. Warrum*,⁴¹ Charles Jackson, the driver of a “low-entry design” garbage truck manufactured by the Crane Carrier Company,

33. *Id.* IND. CODE § 33-1-1.5-3 (1982) provided that “[t]he common law of this state with respect to strict liability in tort is codified and restated as follows . . .” This language was deleted in the 1983 amendment.

34. *Masterman*, 530 N.E.2d at 316.

35. *State Farm Fire & Casualty Co. v. Structo Div., King Seeley Thermos Co.*, 540 N.E.2d 597 (Ind. 1989).

36. *Id.* at 598.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 597.

41. 535 N.E.2d 1207 (Ind. Ct. App. 1989).

was injured when the truck he was driving was involved in an accident with a semi-tractor and trailer driven by Glen Warrum. After impact, the left front corner of the cab collapsed and the front floor board area buckled and moved towards the driver's seat. This created a "pincer" action which crushed Jackson's legs and ankles.⁴² Jackson brought a negligence action against Warrum and his employer as well as a products liability action against Crane and other defendants for manufacturing and distributing a defectively designed truck. The trial court granted Crane's motion for judgment on the evidence with respect to the enhanced injury product liability claim against Crane. On appeal, the First District reversed and remanded for a new trial on that claim.

Crane's position, that Indiana products liability law does not recognize an enhancement of injury claim, relied on the recent decision in *Wixom v. Gledhill Road Machinery Co.*⁴³ In *Wixom*, a car driven by Wixom was struck from behind, causing it to cross a highway and crash into a state highway truck equipped with a snowplow blade manufactured by Gledhill. The court of appeals affirmed the trial court's grant of summary judgment to Gledhill on the grounds that the prior collision was not foreseeable and was an intervening cause precluding the imposition of liability on Gledhill.⁴⁴ Crane maintained that, under *Wixom*, any product liability claim against the manufacturer for enhanced injuries was cut off by the intervening negligence of the driver.⁴⁵

The First District flatly rejected this argument. *Wixom*, it said, "is limited to those cases where the plaintiff seeks to impose liability on the manufacturer as the cause of the *accident* and does not apply to cases where the plaintiff seeks to impose liability on the manufacturer as the cause of *enhanced injuries*."⁴⁶ The *Jackson* court also observed that an "overwhelming" number of jurisdictions have permitted enhanced injury product liability claims⁴⁷ and quoted extensively from the Seventh Circuit opinion in *Huff v. White Motor Corp.*:⁴⁸

[e]ven if a collision is not caused by a structural defect, a collision may precipitate the malfunction of a defective part and cause injury. In that circumstance the collision, the defect, and the injury are interdependent and should be viewed as a combined

42. *Id.* at 1209.

43. 514 N.E.2d 306 (Ind. Ct. App. 1987) (*trans. denied*).

44. *Id.* at 309.

45. *Jackson*, 535 N.E.2d at 1212-13.

46. *Id.* at 1213 (emphasis in original). Indeed, the court in *Wixom* expressly stated that the issue of enhanced injuries was not raised in the motion to correct errors and was, therefore, waived on appeal. 514 N.E.2d at 307 n.1.

47. *Id.* at 1215.

48. 565 F.2d 104 (7th Cir. 1977).

event. Such an event is the foreseeable risk that a manufacturer should assume.⁴⁹

Five months before the *Jackson* decision, the Third District Court of Appeals reached a similar conclusion. In *Masterman v. Veldman's Equipment, Inc.*,⁵⁰ a pickup truck collided with a northbound auto, veered left across the southbound lanes, and collided with Masterman's car, which was southbound in the outside lane. At the time of the accident, there was attached to the pickup a snowplow mount that had been manufactured by Fisher Engineering and sold to the pickup truck driver by Veldman's Equipment. Plaintiffs argued that the presence of the mount on the truck caused more serious injuries than they would otherwise have suffered had the mount either not been there at all or been more safely designed and installed. The trial court granted summary judgment in favor of the defendants and the Mastermans appealed.

The Third District's analysis began with the wording of the 1978 Act: "One who sells any product in a defective condition unreasonably dangerous to any user or consumer . . . is subject to liability for physical harm thereby caused. . . ."⁵¹ The court reasoned that the statute's imposition of liability "for harm caused" does not impose a requirement similar to traditional negligence law that the defective condition of the product "must be a cause of some occurrence, or collision, without which no injuries would have occurred."⁵² Thus, even though the snowplow mount had not contributed to the cause of the collision, plaintiffs were entitled to state a claim that their injuries were specifically and additionally caused by the product.⁵³

2. *But the Courts Split on the Burden of Proof in Second Collision Cases.*—Although the First and Third Districts agreed that a cause of action for enhanced injuries exists in Indiana, they disagreed on the burden placed on the party seeking to prove damages premised on this cause of action. In *Masterman*, the court held that a plaintiff in an enhanced injury claim must prove by a preponderance of the evidence "the specific injuries caused by the defective product."⁵⁴ Further, the court held that, where the claim is that the product was defective because a safer design was available, "it also appears incumbent upon the plaintiff to offer proof of what injuries, if any, would have resulted had the plaintiff's alternative design been employed."⁵⁵

49. *Jackson*, 535 N.E.2d at 1215 (quoting *Huff*, 565 F.2d at 109).

50. 530 N.E.2d 312 (Ind. Ct. App. 1988).

51. IND. CODE § 33-1-1.5-3 (1982).

52. *Masterman*, 530 N.E.2d at 315.

53. *Id.*

54. *Id.* at 317.

55. *Id.* at 318.

By contrast, in *Jackson v. Warrum*, the First District specifically rejected the requirement that the plaintiff prove "what injuries if any would have resulted in a hypothetical accident involving a safer or non-defectively designed product."⁵⁶ It observed that "[t]his rule conflicts with our products liability law which has never required the plaintiff to prove the negative fact of what the injury would have been with a safer product."⁵⁷ Instead, plaintiff must establish merely that the defectively designed product "was a substantial factor in producing damages over and above those which were probably caused as a result of the original impact or collision."⁵⁸

The First District's analysis imposes the following burden of proof on the plaintiff. First, he must prove that the manufacturer placed into the stream of commerce a defectively designed, unreasonably dangerous product. Second, he must prove that a feasible safer alternative product design existed. Finally, the plaintiff must prove that, after the original impact or collision, the defectively designed product proximately caused the enhanced injuries that resulted. This can be satisfied by establishing that the defectively designed product was a "substantial factor" in producing damages over and above those which were probably caused as a result of the original impact or collision. There is, however, no requirement that plaintiff establish the amount of injury that would have resulted in a hypothetical accident involving a safer design.⁵⁹

Once the plaintiff establishes these elements, the burden shifts to the defendant to prove that the damages arising from the enhanced injury are "apportionable."⁶⁰ If the trial court determines that the injuries to the plaintiff are indivisible as a matter of law, then all defendants, including the manufacturer of the defective component, may be held jointly and severally liable for the entire injury.⁶¹ If, however, the court finds that "reasonable minds could differ on the issues of whether the plaintiff's injuries are divisible and apportionable, then the trial court should submit the issues to the trier of fact."⁶²

C. Manufacturer's Duty to Warn Employees of Its Purchasers

1. *Jarrell v. Monsanto*.—An extensive analysis of the duty to warn is provided in *Jarrell v. Monsanto Co.*⁶³ Arthur Jarrell, an employee of

56. 535 N.E.2d 1207, 1219 (Ind. Ct. App. 1989).

57. *Id.*

58. *Id.*

59. *Id.* at 1220.

60. *Id.*

61. *Id.*

62. *Id.*

63. 528 N.E.2d 1158 (Ind. Ct. App. 1988).

Firestone Industrial Products, was filling bins with pigments used in the process of manufacturing rubber products. After pouring two fifty pound bags of sulphur through the upper hatch of a two-story bin, he slid the door closed. Immediately thereafter, the door blew back and Jarrell found his shirt and gloves aflame with molten sulphur.⁶⁴ Although no specific cause for the explosion was established, it was known that the sulphur product in question is easily ignited when dispersed in air.⁶⁵ Arthur and his wife (collectively, "the Jarrells") brought suit against Monsanto (the manufacturer of the sulphur) and several other parties. The Jarrells asserted "claims of negligent failure to warn and of strict liability for selling an inherently dangerous product" against Monsanto.⁶⁶ The trial court granted Monsanto's motion for summary judgment and the Jarrells appealed.

It was undisputed that the bags of sulphur supplied by Monsanto to Firestone contained warning labels, including the following: "WARNING!" and "SULPHUR DUST SUSPENDED IN AIR IGNITES EASILY!" as well as "Avoid creating dust in handling!"⁶⁷ Monsanto had also mailed material safety data sheets to Firestone approximately ten months before the accident. These data sheets contained warnings identical to those on the bags and additional warnings as well. The trial court found that Jarrell had not read the warning labels on the bags although he was aware that such labels existed.⁶⁸ It further found that it was Firestone's policy to fill the storage bins from the bottom hatch first. In filling the bin from the top hatch Jarrell had, therefore, violated his employer's standard operating procedure.⁶⁹ Thus, the trial court concluded that the buyer of the product (Firestone) was warned, that the user of the product (Jarrell) was warned, and that Jarrell had failed to heed the warnings and misused the product.⁷⁰

The court of appeals reversed the trial court's grant of summary judgment in favor of Monsanto.⁷¹ According to the court, the Jarrells were required to prove four elements in a claim of negligent failure to warn.⁷² First, they must demonstrate that Monsanto supplied a product with a concealed danger.⁷³ Second, Monsanto must have known or had

64. *Id.* at 1160.

65. *Id.*

66. *Id.*

67. *Id.* at 1161.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.* at 1161-62.

72. *Id.*

73. *Id.* at 1161.

reason to know of the danger.⁷⁴ Third, Monsanto must have failed to adequately warn the user of the danger.⁷⁵ Finally, the failure to adequately warn must be the approximate cause of Jarrell's injuries.⁷⁶ The court held that each of the above elements was properly a question to be resolved by the trier of fact; therefore, summary judgment was improper.⁷⁷

With respect to the first element, although Jarrell had worked with the sulphur product before, it was not clear that his past experience would "necessarily alert a user to all dangers associated with a product."⁷⁸ Jarrell stated at trial (apparently in an affidavit) that he was not aware of the "possibility of spontaneous combustion." Therefore, a reasonable trier of fact might find either way with respect to whether Jarrell should have perceived the danger which caused his injury or whether the danger was, in fact, "concealed."⁷⁹ With respect to the second element, it was undisputed that Monsanto was aware of the dangerous nature of the product. These two elements jointly, according to the court, "create a question of fact as to whether Monsanto had a duty to warn of danger."⁸⁰

The third element, the adequacy of Monsanto's warnings, is "classically a question of fact reserved to the trier of fact and, therefore, usually an inappropriate matter for summary judgment."⁸¹ The adequacy of the warning given by Monsanto was said to turn on "the adequacy of the factual content, the adequacy of the manner in which that content is expressed, and the adequacy of the method of conveying these expressed facts."⁸² The court refused to find that the undisputed warnings were adequate as a matter of law.⁸³ Reviewing the record, including the affidavit of an expert tendered by the plaintiffs,⁸⁴ the court held that "it would permit a *prima facie* conclusion that the warnings were in-

74. *Id.*

75. *Id.*

76. *Id.* at 1162.

77. *Id.*

78. *Id.* (citations omitted).

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 1162-63.

83. *Id.* at 1163.

84. The trial court had rejected the expert's affidavit as constituting "speculation" about what the plaintiff might have seen or done if the warnings on the bag had been different. *Id.* at 1161. The court of appeals noted that warnings experts are "used more and more frequently in products liability cases," *Id.* at 1163 n.3 (citing cases), and stated that such experts are "a significant source of information upon the use of the product and the appropriateness of the warnings in comparison to that use." *Id.* While the appeals court rejected the trial court's conclusion that such evidence is overly speculative, the court did not address the foundation for admission of such expert testimony. *Id.*

adequate.⁸⁵ As part of this element, the court also held that duty to warn extended to Arthur Jarrell:

Indiana negligence law clearly states that a manufacturer or supplier has a duty to warn all who may reasonably be foreseen as coming in contact with the product. Without question Arthur was a person who could be foreseen as coming in contact with the product.⁸⁶

Finally, the element of proximate cause was also, according to the court, appropriately a jury question that is not amenable to resolution at the summary judgment stage.⁸⁷

The court applied essentially the same principles in ruling that Monsanto was not entitled to summary judgment on the plaintiffs' strict liability theory. "In Indiana, the issue of the adequacy of warnings in a strict liability case is governed by the same concepts as in negligence."⁸⁸ The court held there were triable issues of fact on the adequacy of the warning,⁸⁹ on whether the product was "unreasonably dangerous,"⁹⁰ and on proximate cause.⁹¹ In addition, the court rejected Monsanto's argument that it was entitled to judgment as a matter of law on the defenses of contributory negligence, misuse, lack of proximate cause, and intervening cause.⁹²

2. *The Jarrell Holding in Light of Prior Cases.*—Central to the *Jarrell* decision was the court's flat assertion, citing *Hoffman v. E.W. Bliss Co.*,⁹³ that Monsanto's duty to warn the plaintiff is "nondelegable."⁹⁴ This would seem to suggest that, irrespective of the adequacy of the warnings a manufacturer may provide to the *employer* of a user, the manufacturer's obligation to the user-employee is not discharged. This view is reinforced by the court's statement that "Indiana negligence

85. *Id.*

86. *Id.* at 1162 (citations omitted) (emphasis added).

87. *Id.* at 1163.

88. *Id.* at 1166. At the end of the opinion the court concluded that: in cases involving deficient or absent warnings as the sole "defect" or "defective condition," we have nothing more and nothing less than a negligence action to which the defenses of contributory negligence, comparative negligence, etc. are not available.

Id. at 1168 n.7.

89. *Id.*

90. *Id.* at 1167.

91. *Id.*

92. See *id.* at 1164-65 (addressing negligence defenses); *id.* at 1167-68 (addressing strict liability defenses).

93. 448 N.E.2d 277 (Ind. 1983).

94. *Jarrell*, 528 N.E.2d at 1164.

law clearly states that a manufacturer or supplier has a duty to warn all who may reasonably be foreseen as coming in contact with the product."⁹⁵ If this is the position of the court, it seems inconsistent with *Hoffman* as well as other cases dealing with a manufacturer's duty to warn.

In *Hoffman*, the plaintiff was an employee of Regency Electronics. His fingers were crushed while he was operating a metal punch press produced by the defendant Bliss Company. Among the issues examined by the supreme court was whether there was a duty on the manufacturer to provide instructions to the employee of the purchaser of the machine.⁹⁶

Central to the analysis are two instructions provided to the jury. One stated that:

[W]here warnings or instructions are required to make a product nondefective, it is the duty of the manufacturer to provide such warnings in a form that will reach the ultimate consumer and inform of the risk and inherent limits of the product. The duty to provide a nondefective product is non-delegable.⁹⁷

The second instruction stated, in pertinent part:

The manufacturer of a press, such as the defendant E.W. Bliss Company, is entitled to assume that the company using its press will adequately safeguard the press for the operation for which it is being used and will instruct its employees in the operation of the press and the need to employ the safety devices provided.⁹⁸

The supreme court specifically held that these two instructions together correctly state the law: "The two instructions read together do not serve . . . to absolve the manufacturer of any duty to warn. Rather they indicate the manufacturer does have a duty to provide warnings or instructions that will reach the ultimate consumer or user."⁹⁹ Thus, at least under the fact pattern present in *Hoffman*, it is clear that a manufacturer's duty to warn does not necessarily extend directly to all who may reasonably be foreseen as using the product. If the manufacturer provides adequate warnings to an employer of the user, it is entitled to assume that the employer will, in turn, instruct its employees.

95. *Id.* at 1162.

96. *Hoffman*, 448 N.E.2d at 278-80.

97. *Id.* at 282.

98. *Id.* at 281.

99. *Id.* at 283.

This principle is a variant of what is known as the "learned intermediary" or "sophisticated user" doctrine. This doctrine originally developed in the context of prescription drugs and the drug manufacturer's duty to warn was limited to the provision of adequate warnings to the *prescribing physician*. The manufacturer of the drugs was considered to be under no duty to directly warn the ultimate consumer of the drugs:

It has been established that, in the case of prescription drugs . . . the manufacturer has no obligation to warn a consumer of that drug so long as the prescribing physician has been adequately warned of any potentially adverse side effects. The prescribing physician acts as a "learned intermediary" between the manufacturer and the consumer, since he is in the best position to weigh the benefits against the risks of a particular drug therapy.¹⁰⁰

The sophisticated user doctrine now extends well beyond the limited scope of prescription drugs. Many cases have held that an employer or supervisor who, with knowledge of the dangers of a product used by an employee, failed to provide the requisite warnings to that employee relieved the manufacturer for injuries caused by the failure to warn.¹⁰¹ The doctrine is frequently applied to manufacturers of chemicals. In *Younger v. Dow Corning Corp.*,¹⁰² the manufacturer of a chemical compound was held free of liability on a showing that the chemicals had been supplied to an industrial user with adequate warnings. When an employee of that user was subsequently injured and brought suit against the manufacturer, the court found the manufacturer had no duty to warn the employee but, rather, could reasonably anticipate that the industrial user of its products would pass on to its employees the substance of the warnings provided by the manufacturer.¹⁰³

100. Timm v. Upjohn Co., 624 F.2d 536, 538 (5th Cir. 1980), *cert. denied*, 449 U.S. 1112 (1981) (citations omitted). See also Givens v. Lederle, 556 F.2d 1341 (5th Cir. 1977); Davis v. Wyeth Laboratories, 399 F.2d 121 (9th Cir. 1968).

101. For example, in *Cook v. Branick Mfg. Co.*, 736 F.2d 1442 (11th Cir. 1984), a tire rim exploded and struck a worker in the head. The court, applying Alabama law, held that the manufacturer of the rims as well as the franchisor who distributed the rims to the victim's employer were not liable on a theory of failure to warn. The denial of recovery was premised on the fact that the duty to warn had been appropriately discharged by informing the employer of the victim. Similarly, the manufacturer of an intrauterine device was held free of liability where the dispensing physician, aware of the dangers attendant upon its use, nonetheless prescribed it to a patient. *Terhune v. A.H. Robins Co.*, 90 Wash. 2d 9, 577 P.2d 975 (1978).

102. 202 Kan. 674, 451 P.2d 177 (1969).

103. Similarly, in an action for indemnification by a water repellent manufacturer against the oil company that had provided a flammable solvent for use in the production of the water repellent, the court held that, since the oil company had no opportunity to

The sophisticated user doctrine is accepted in Indiana. A recent statement of the doctrine is found in *Phelps v. Sherwood Medical Industries, Inc.*¹⁰⁴ In this case, a patient brought a products liability action against the manufacturer of an allegedly defective heart catheter. The catheter broke inside the patient's heart when a nurse attempted its removal. The plaintiff alleged that the manufacturer of the catheter, Sherwood, breached its duty to warn the plaintiff of the potential hazard of breakage.

The fundamental issue, as stated by the Seventh Circuit, was whether Sherwood had a duty to warn users of the catheter who were "down-line" of the patient's physician.¹⁰⁵ The circuit court first observed that, in the context of prescription drugs, it is controlling law in Indiana that a drug manufacturer completely discharges its duty to warn the *patient* by discharging its duty to warn the *physician*.¹⁰⁶ In holding that the "learned intermediary" doctrine has equal applicability to cases involving medical instruments, the court found that Sherwood had no duty whatever to warn the plaintiff. That duty was completely discharged by Sherwood's issuance of warnings to the plaintiff's physician.¹⁰⁷

As in other jurisdictions, the application of this principle is not confined by Indiana courts to the context of medical drugs and instrumentalities. In *Shanks v. A.F.E. Industries*,¹⁰⁸ the plaintiff brought an action against the manufacturer of a grain dryer for injuries sustained while repairing an elevator leg which was connected to the dryer. The elevator leg was automatically activated during the "unload" phase of the dryer's operation and the automatic activation of the leg was responsible for plaintiff's injuries.

The plaintiff in *Shanks* was employed by Grammer, a firm engaged in the business of buying grain from farmers and reselling it on the

warn the ultimate user of the water repellent, and since the manufacturer of the repellent knew of the hazardous nature of the solvents comprising the repellent, the oil company had no duty to warn the ultimate user. *Hill v. Wilmington Chem. Corp.*, 279 Minn. 336, 156 N.W.2d 898 (1968). See also *E.I. Du Pont De Nemours & Co. v. Ladner*, 221 Miss. 378, 73 So. 2d 249 (1954); *Wilson v. E-Z Flo Chem. Co.*, 281 N.C. 506, 189 S.E.2d 221 (1972); *Hargis v. Doe*, 3 Ohio App. 3d 36, 443 N.E.2d 1008 (1981); *Reed v. Pennwalt Corp.*, 22 Wash. App. 718, 591 P.2d 478, *appeal dismissed*, 93 Wash. 2d 5, 604 P.2d 164 (1979).

104. 836 F.2d 296 (7th Cir. 1987) (applying Indiana law). A detailed analysis of this decision is provided in Rosiello & Weisenberger, *Survey of Indiana Products Liability Cases: 1987-1988*, 22 IND. L. REV. 263, 279-83 (1989).

105. 836 F.2d at 300.

106. *Id.* at 303 (citing *Ortho Pharmaceuticals Corp. v. Chapman* (1979)), 180 Ind. App. 33, 388 N.E.2d 541, (*trans. denied*).

107. *Id.*

108. 416 N.E.2d 833 (Ind. 1981).

market. Charles Whittington, a part owner and manager of Grammer, had purchased the dryer through a distributor in Michigan. The automatic feature of the dryer was known by Whittington.¹⁰⁹ Whittington was, in effect, a "learned intermediary." Since "[n]o additional warning or literature that could be furnished him by A.F.E. at the time of the sale could have improved upon his understanding of the characteristics of the machine" the supreme court found that A.F.E. had no duty to warn the plaintiff.¹¹⁰ A.F.E. had fully discharged its duty by warning the employer. If a duty to warn still existed, it fell squarely on the shoulders of the plaintiff's employer: "[f]undamentally, that responsibility lay with Grammer, as the creator of the complex *and as Shanks' employer.*"¹¹¹

The *Jarrell* court dismissed the applicability of *Shanks* with the observation that "[o]ur case involves no complex machinery—only bags of sulphur which Monsanto knew would have to be opened and dumped to be used."¹¹² Yet, the threshold issue in *Shanks* (as well as in *Phelps*) was precisely the issue in *Jarrell*: whether the relationship between the supplier of an allegedly defective product and the plaintiff was one in which the law imposes a duty to warn.¹¹³

The Second District's decision to remand for a jury determination of Monsanto's duty to warn seems incorrect for two reasons. First, under Indiana law, the duty to warn that a manufacturer owes to those who use its products is a question of law for the court:¹¹⁴ "In determining whether the relation [between parties] shown gives rise to a duty to use care, the court decides a pure question of law. This question cannot be submitted to a jury."¹¹⁵ *Jarrell*, however, requires a jury determination of precisely this issue.¹¹⁶ Second, by remanding for jury determination of this issue, the Second District has held, at least implicitly, that even if a manufacturer provides adequate warnings to the *purchaser* of a product, its duty to warn an employee of that purchaser is not discharged. This seems inconsistent with *Shanks*, *Phelps*, and *Hoffman*.

109. *Id.* at 837.

110. *Id.* (quoting *Shanks v. A.F.E. Indus.*, 403 N.E.2d 849, 857 (Ind. Ct. App. 1980)).

111. *Id.* at 838 (emphasis added).

112. *Jarrell*, 528 N.E.2d at 1165.

113. The threshold question with respect to a manufacturer's liability for damages allegedly sustained as a result of a manufacturer's failure to adequately warn is whether the manufacturer was, in fact, under a duty to warn. *American Optical Co. v. Weidenhamer*, 457 N.E.2d 181, 187 (Ind. 1983).

114. *Zahora v. Harnischfeger Corp.*, 404 F.2d 172, 175 (7th Cir. 1968).

115. *Union Traction Co. v. Berry*, 188 Ind. 514, 520-21, 121 N.E. 655, 657 (1919).

116. 528 N.E.2d 1158, 1162 (Ind. Ct. App. 1988).

By the reasoning of these cases, Monsanto is not liable to Jarrell unless Monsanto failed in its duty to warn Jarrell's employer. If summary judgment in favor of Monsanto was improper, it was so because the adequacy of Monsanto's warnings to Firestone may have properly been an issue left to resolution by the trier of fact. The opinion in *Jarrell*, however, does not distinguish between the adequacy of warnings provided to Firestone and those provided to Firestone's employee.

D. Products Liability Act Statute of Repose Held Inapplicable to Personal Injury Action Based on Asbestos Exposure

In *Covalt v. Carey-Canada, Inc.*,¹¹⁷ the following question was certified to the Indiana Supreme Court: "Whether a plaintiff may bring suit within two years after discovering a disease and its cause, notwithstanding that the discovery was made more than ten years after the last exposure to the product that caused the disease."¹¹⁸ On September 8, 1989, the court handed down an important decision which answered the certified question in the affirmative.¹¹⁹

Clermont Covalt worked with asbestos at Proko Industries in Indiana between 1963 and 1971. He alleged that Carey Canada and Union Carbide Corporation furnished Proko with raw asbestos and did not properly warn either Proko or the plaintiff of its dangers. In 1986, Covalt was diagnosed as having lung cancer and asbestosis. He and his wife brought this action in the United States District Court in the Southern District of Indiana. The defendants filed motions for summary judgment based on the ten year statute of repose in the Indiana Products Liability Act which reads, in pertinent part: "[A]ny product liability action in which the theory of liability is negligence or strict liability in tort must be commenced within two (2) years after the cause of action accrues or within ten (10) years after delivery of the product to the initial user or consumer."¹²⁰

117. 860 F.2d 1434 (7th Cir. 1988).

118. *Id.* at 1441. In the trial court, United States District Judge McKinney had denied the defendants' motions for summary judgment, holding that *Barnes v. A. H. Robins Co.*, 476 N.E.2d 84 (Ind. 1985) "created an exception to the ten year statute of repose in products liability cases in cases dealing with long term exposure to substances which cause disease. . . ." *Covalt v. Carey-Canada, Inc.*, 672 F. Supp. 367, 369 (S.D. Ind. 1987). Other Indiana district courts had held that the statute of repose did apply to bar the prosecution of asbestos-related claims. See generally Rosiello and Weisenberger, *Survey of Indiana Products Liability Cases: 1987-88*, 22 IND. L. REV. 263, 283-90 (1989).

119. *Covalt*, 543 N.E.2d 382 (Ind. 1989).

120. IND. CODE § 33-1-1.5-5 (1988).

A literal application of this statute would have barred the plaintiffs' action.¹²¹ Although it was brought within two years of the time the cause of action accrued, it was not brought within ten years after delivery of the product to the initial user or consumer. The court, however, carved out an exception to the statute if a disease is the result of protracted exposure to a foreign substance, for "then the injury is not only ongoing and continuous in nature, but becomes compounded as time passes. By definition, the injury begins from the moment the foreign substance is introduced into the body, even if the resultant disease does not manifest itself until many years later."¹²² According to the court, the statute of repose is simply "inapplicable to cases involving protracted exposure to an inherently dangerous foreign substance which is visited into the body."¹²³

Defendants had argued that the result in this action should be controlled by *Dague v. Piper Aircraft Corp.*¹²⁴ In that case, the Indiana Supreme Court held that the statute of repose barred the plaintiff's action for wrongful death where her husband died as a result of injuries sustained in an airplane crash which occurred more than ten years after the aircraft was first placed in the stream of commerce.¹²⁵ The *Covalt* court, however, distinguished *Dague* on two grounds. First, *Dague* involved a one-time occurrence resulting in immediate injury and death less than two months thereafter.¹²⁶ Second, the airplane crash occurred outside of the ten year statute of repose whereas *Covalt*'s alleged injury and disease were the result of protracted exposure to asbestos, "an inherently dangerous product that was just as dangerous when first introduced into the market as it was when it was visited into his body for the very first time."¹²⁷

The majority opinion drew a sharp distinction between injuries resulting from "product failure" and those resulting from protracted exposure:

[B]ecause of the long latency period with asbestos-related diseases, most plaintiffs' claims would be barred even before they knew

121. In *Dague v. Piper Aircraft Corp.*, 275 Ind. 520, 418 N.E.2d 207 (1981), the Indiana Supreme Court held that "or" in this provision must be read as "and." "The obvious intent of the statute . . . is that the action must be brought within two years after it accrues, but in any event within ten years after the product is first delivered to the initial user or consumer. . . ." 275 Ind. at 525 418 N.E.2d at 210.

122. 543 N.E.2d at 385.

123. *Id.* at 385.

124. 275 Ind. 520, 418 N.E.2d 207 (1981).

125. *Id.* at 528, 418 N.E.2d at 212.

126. *Covalt*, 543 N.E.2d at 386.

127. *Id.*

or reasonably could have known of their injury or disease and they would be denied their day in court if the ten year statute of repose were applied. To require a claimant to bring his action in a limited period in which, even with due diligence, he could not be aware that a cause of action exists would be inconsistent with our system of jurisprudence.¹²⁸

Chief Justice Shepard and Justice Dickson each filed separate dissents. Justice Shepard found no principled basis for the distinction between "product failure" claims of the type defeated in *Dague* and the present asbestos related claim:

[O]ne is led to wonder how *Dague* would have turned out had the plaintiff been able to plead a slow deterioration of badly manufactured metal, deterioration leading ultimately to failure and crash. Would John Dague's widow have been barred had she been able to argue that her husband was the victim of a "slow, progressive, undetectable injury"? Apparently, she would have been told simply that defective asbestos is an exception to Indiana's statute of repose and defective metal is not.¹²⁹

According to the Chief Justice, the "best" explanation as to why the majority chose not to follow what he considers to be the clear mandate of the legislature to bar *all* such actions is that the majority felt that the statute of repose, when applied in the context of asbestos type litigation, was "inconsistent with our system of jurisprudence."¹³⁰ That view, according to Justice Shepard, would, however, lead to a general abrogation of statutes of repose. "If there is a principled basis for singling out one class of injured parties, victims of asbestosis, and shutting out all other defective product victims, I fail to discern it in the majority opinion."¹³¹

Justice Dickson also found the "judicial revision" of the Indiana Products Liability Act unacceptable:

Courts are not at liberty to construe a statute that is unambiguous. . . . The plain language of the products liability ten-year statute of repose is clear and free from ambiguity. It is therefore our duty to accept and apply the statute as written unless it exceeds the power of the legislature to act.¹³²

128. *Id.* at 387 (citation omitted).

129. *Id.* at 388 (Shepard, C.J., dissenting).

130. *Id.*

131. *Id.* at 389.

132. *Id.* (Dickson, J., dissenting) (citations omitted). In *Miller v. Mayberry*, 506

Rather than “substitute its judgment” for that of the legislature, Justice Dickson suggested that the court engage in analysis of the constitutionality of such a statute under article 1, sections 12 and 23 of the Indiana Constitution.¹³³ Section 12 provides: “All courts shall be open; and every person, for injury done to him in his person, property or reputation, shall have remedy by due course of law.” Section 23 provides: “The General Assembly shall not grant to any citizen, or class of citizens, privileges or immunities which, upon the same terms, shall not equally belong to all citizens.”

According to Justice Dickson, the relationship between the statute of repose and these constitutional provisions is, at best, “unresolved.”¹³⁴ In *Dague*, the court held that the products liability statute of repose did not contravene Section 12.¹³⁵ Subsequent cases, according to Justice Dickson, present “significant qualification or equivocation on the constitutional issues.”¹³⁶ As an example, Justice Dickson cited *Bunker v. National Gypsum Co.*,¹³⁷ where the court stated that a “statute of limitations will comport with the constitutional demand for due process so long as it provides a reasonable time for the bringing of an action.”¹³⁸

N.E.2d 7 (Ind. 1987), Justice Pivarnik (who authored the majority opinion in *Covalt*) made the same point in a case involving the “pecuniary loss rule”—the rule that damages for the loss of love and affection resulting from injury or death to a minor child are not compensable under the prevailing interpretation of Indiana statutory law. IND. CODE § 34-1-1-8 (1982). There, Justice Pivarnik stated:

We must presume the Legislature has been aware of our construction of its enactments. . . . The Legislature has the power to change the rule if it disagrees with the Court’s constructions of its legislative enactments or feels that there is a need to change that rule based on the needs or requirements of society.

506 N.E.2d at 11. It is difficult to reconcile Justice Pivarnik’s approach in *Miller* with the approach of *Covalt*.

133. *Covalt*, 543 N.E.2d at 389-90 (Dickson, J., dissenting).

134. *Id.* at 390.

135. 275 Ind. 520, 530, 418 N.E.2d 207, 213 (1981).

136. *Covalt*, 543 N.E.2d at 390 (Dickson, J., dissenting).

137. 441 N.E.2d 8, 12 (Ind. 1982), *appeal dismissed*, 460 U.S. 1076 (1983).

138. Although it contained the language quoted by Justice Dickson, *Bunker v. National Gypsum Co.* does not otherwise support a constitutional attack on the statute of repose. The *Bunker* opinion (written by Justice Pivarnik) rejected the claim that the three-years-from-last-exposure limitations period in the Occupational Diseases Act was unconstitutional as applied to an asbestos claim. *Bunker* overturned a court of appeals decisions that the statute was unconstitutional because it found that the latency period between exposure and the onset of disease was more than three years. The supreme court expressed strong disapproval of the lower court’s holding as “usurping the legislature’s constitutionally mandated function” to determine limitations periods. 441 N.E.2d at 13. Justice Dickson also relied on *Rohrbaugh v. Wagoner*, 274 Ind. 661, 413 N.E.2d 891 (1980). This case, like *Bunker*, provides little basis for a finding that the statute of repose

At least arguably, this requirement is not satisfied by a statute of repose in the factual context of asbestosis litigation. For this reason, Justice Dickson concluded:

I would therefore favor that this Court engage in an analysis of the product liability statute of repose, not by way of statutory construction as undertaken by the majority, but rather by constitutional analysis so that we may review questions of its constitutionality under Art. 1, §§ 12 and 23 of the Constitution of Indiana, and so that we may reconsider and resolve the apparent inconsistencies between *Dague* and other recent analogous cases.¹³⁹

There are serious analytical problems with the majority opinion in *Covalt*. While the court held that "our statute of repose [is] inapplicable to cases involving protracted exposure to an inherently dangerous foreign substance,"¹⁴⁰ there is no basis in the statutory language to distinguish such a case from any other products liability claim. The majority opinion attempted to base a distinction upon the claimed fact that asbestos is "[a]n inherently dangerous substance . . . [that] is just as hazardous when it is first introduced into the market as it is ten (10) or even fifty (50) years later."¹⁴¹ For this reason, the court stated that "no purpose is served in legally distinguishing" between new asbestos and asbestos that has been in the market more than ten years.¹⁴² Even accepted at face value there are difficulties in limiting this principle. An airplane, for example, might have a design defect that does not result in injury,

is unconstitutional. In *Rohrbaugh*, the court upheld a provision of the Medical Malpractice Act which required minors between the ages of 6 and 21 to sue within two years of the alleged malpractice. The court stated:

The [statute of limitations] bar is conceived as cutting off the availability of a remedy or in the alternative as limiting the substantive right which gives rise to a claim. Neither conception carries with it the idea that the bar infringes upon a fundamental right to seek redress in court.

274 Ind. at 664, 413 N.E.2d at 893 (citations omitted). Thus, even if the statute of repose is viewed as terminating the substantive right to bring a product liability action, it does not run afoul of article 1, section 12. "[T]he right to bring a common law action is not a fundamental right." *Dague v. Piper Aircraft Corp.*, 275 Ind. 520, 529, 418 N.E.2d 207, 213 (1981).

139. *Covalt*, 543 N.E.2d at 390 (Dickson, J., dissenting). Chief Justice Shepard's dissent merely noted that there are potential constitutional issues. He found that "the statute's constitutionality is not squarely before us" because the parties had not thoroughly addressed the issue. Moreover, he stated that, even if squarely presented, he "would be reluctant" to make a constitutional ruling in a case certified to the Indiana Supreme Court from the federal court of appeals. 543 N.E.2d at 389.

140. 543 N.E.2d at 385.

141. *Id.*

142. *Id.*

purely as a matter of chance, until after ten years of use. In that case, the airplane would be "just as hazardous when it is first introduced into the market as it is ten . . . years later;"¹⁴³ yet under *Dague* and *Covalt* the injury claim would be barred by the statute of repose.¹⁴⁴

More fundamentally, the majority's refusal to distinguish between "older" and "newer" asbestos because "no purpose is served" begs the underlying question of whether the court or the legislature makes such policy decisions. If it is the legislature, as the supreme court has repeatedly held,¹⁴⁵ then the majority opinion failed to articulate any legislative basis for its finding that the statute of repose serves "no purpose" in an asbestos-related case. On the contrary, in *Dague* the court found that the legislature, in adopting the statute of repose, "clearly intended to place an *absolute* time limit on liability for a product's defects. . . ."¹⁴⁶ "[T]he legislature clearly intended that *no* cause of action would exist on any such product liability theory after ten years."¹⁴⁷ If, on the other hand, the majority based its decision on its own determination of the "purpose" to be served by the statute of repose, the court did not provide any jurisprudential basis to permit it to create legal distinctions where they cannot be found in unambiguous statutory language.¹⁴⁸

The *Covalt* court stressed the limited nature of its opinion: "[O]ur holding today is limited to the precise factual pattern presented and does *not* apply to worker's occupational disease compensation actions. This opinion is accordingly limited to product liability actions in which the theory of liability is negligence or strict liability in tort."¹⁴⁹ The

143. *Id.*

144. See also 543 N.E.2d at 388-89 (Shepard, C. J., dissenting) (noting other similar problems in the majority opinion).

145. In *Sidle v. Majors*, 264 Ind. 206, 208, 341 N.E.2d 763, 766 (1976), the principle was well-stated: "We have no right to substitute our convictions as to the desirability or wisdom of legislation for those of our elected representatives." *Accord*, e.g., *Bunker v. National Gypsum Co.*, 441 N.E.2d 8, 11 (Ind. 1982), *appeal dismissed*, 460 U.S. 1076 (1983) ("[t]his Court and the Court of Appeals must not . . . substitute judicial judgment for legislative judgment in legislative matters that neither affect fundamental rights nor proceed along suspect lines") (Pivarnik, J.).

146. 418 N.E.2d at 210, quoting *Amerac, Inc. v. Gordon*, 374 N.E.2d 946, 948 n.4 (1979) (emphasis in original).

147. *Id.* at 212 (emphasis in original).

148. Both dissents made this point in forceful terms. See 543 N.E.2d at 387-88 (Shepard, C. J., dissenting) ("[t]oday's opinion neither defines the boundaries of the exception it creates nor provides so much as a fig leaf justifying such judicial creativity"); *Id.* at 389 (Dickson, J., dissenting) (describing the majority holding as "unacceptable" "judicial revision" of the statute of repose). Justice Pivarnick, the author of the majority opinion in *Covalt*, has himself made this argument eloquently in earlier decisions. See, e.g., *Miller v. Mayberry*, 506 N.E.2d 7, 11 (Ind. 1987); *Bunker v. National Gypsum Co.*, 441 N.E.2d 8, 11-14 (Ind. 1982), *appeal dismissed*, 460 U.S. 1076 (1983).

149. 543 N.E.2d at 387.

actual boundaries of and limitations on the rule announced in *Covalt* will be determined only through future appellate decisions.

E. New Statute Passed Addressing Asbestos-Related Claims

In the 1989 legislative session, while *Covalt* was pending before the supreme court, the Indiana General Assembly amended the Products Liability Act to add Indiana Code section 33-1-15-5.5 ("section 5.5"), which created a limited exception to the statute of repose for asbestos-related claims.¹⁵⁰ The statutory provisions of section 5.5 are limited to personal injury or property damage claims against "persons who mined and sold commercial asbestos" or against funds set up to pay asbestos claims in connection with actual or threatened bankruptcy proceedings.¹⁵¹ Thus, the statute does not apply to claims against entities that merely sold asbestos products.

With respect to claims for personal injury, section 5.5 provides that the cause of action accrues "when the injured person knows that the person has an asbestos related disease or injury."¹⁵² This language is narrower than the discovery rule announced in *Barnes v. A. H. Robins*

150. Enactment of May 3, 1989, Pub. L. No. 217-1989, § 4, 1989 Ind. Acts 1603 (codified as IND. CODE ANN. § 33-1-1.5-5.5 (West Supp. 1989)). Section 5.5 provides as follows:

(a) A product liability action that is based on property damage resulting from asbestos or personal injury, disability, disease, or death resulting from exposure to asbestos must be commenced within two (2) years after the cause of action accrues. The subsequent development of an additional asbestos related disease or injury is a new injury and is a separate cause of action.

(b) A product liability action for personal injury, disability, disease, or death resulting from exposure to asbestos accrues on the date when the injured person knows that the person has an asbestos related disease or injury.

(c) A product liability action for property damage accrues on the date when the injured person knows that the property damage has resulted from asbestos.

(d) This section applies only to product liability actions against persons who mined and sold commercial asbestos and to product liability actions against funds which have, as a result of bankruptcy proceedings or to avoid bankruptcy proceedings, been created for the payment of asbestos related disease claims or asbestos related property damage claims.

(e) For the purposes of IC 1-1-1-8, if any part of this section is held invalid, the entire section is void.

(f) Except for the cause of action expressly recognized in this section, this section does not otherwise modify the limitation of action or repose period contained in section 5 of this chapter.

The statute of repose was also amended to reflect the exceptions contained in Section 5.5. IND. CODE ANN. § 33-1-1.5-5 ("Except as provided in Section 5.5 of this chapter, a product liability action must be commenced . . .").

151. IND. CODE ANN. § 33-1-1.5-5.5(d) (West Supp. 1989).

152. *Id.* § 33-1-1.5-5.5(b).

Co.,¹⁵³ under which the cause of action accrues when "the plaintiff knew or should have discovered that she suffered an injury or impingement and that it was caused by the product or act of another."¹⁵⁴ With respect to the accrual of a claim of property damage caused by asbestos, section 5.5 likewise imposes an actual knowledge standard.¹⁵⁵

In addition, section 5.5 states that: "[t]he subsequent development of an additional asbestos related disease or injury is a new injury and is a separate cause of action."¹⁵⁶ This would change the rule, generally followed in Indiana, that there is a single cause of action for personal injury and that all damages, for past and future injuries, must be recovered in a single action.¹⁵⁷ Such change may be a natural consequence of the common law discovery rule stated in *Barnes*, but, to date, no Indiana case has addressed that issue.

The apparent intent of the legislature in section 5.5 was to create a narrow exception to the statute of repose for certain asbestos-related claims. The decision in *Covalt*, holding that the statute of repose is "inapplicable" to a personal injury asbestos claim,¹⁵⁸ has preempted section 5.5 to some extent. However, the statute should still be effective with respect to property damage claims against the potential defendants described in section 5.5, because property damage claims are not within either the rationale or the limited holding of *Covalt*.¹⁵⁹ In other words, the ten-year statute of repose should continue to apply to property damage claims, except for those limited claims cognizable under section 5.5.

III. CONCLUSION

Among the more significant judicial developments over the survey period were the "abolition" of the legislatively mandated statute of repose in products liability cases involving protracted exposure to a

153. 476 N.E.2d 84 (Ind. 1985).

154. 176 N.E.2d at 87-88.

155. IND. CODE ANN. § 33-1-1.5-5.5(a) (West Supp. 1989).

156. *Id.* § 33-1-1.5-5.5(a).

157. *E.g.* Shideler v. Dwyer, 275 Ind. 270, 283-84, 417 N.E.2d 281, 289-90 (1981); Evansville Am. Legion Home Ass'n v. White, 141 Ind. App. 574, 583, 230 N.E.2d 623, 628 (1967), *cert. denied*, 393 U.S. 859 (1968); Cleveland, C. C. & I. Ry. Co. v. Newell, 104 Ind. 264, 277, 3 N.E. 836, 843 (1885); *see also* 1 INDIANA PATTERN JURY INSTRUCTIONS (2nd Ed. 1989), Instruction No. 11.25 (describing as an element of damages "the reasonable expense of future medical care, treatment, and services").

158. Covalt v. Carey-Canada, Inc., 543 N.E.2d 382, 385 (Ind. 1989).

159. *See id.* at 386 (rationale based upon "slow, progressive, undetectable injury and latent disease"); and *id.* at 387 ("our holding today is limited to the precise factual pattern presented").

foreign substance¹⁶⁰ and the recognition by the First and Third District Courts of Appeals of the "second collision" doctrine.¹⁶¹ Manifestly, however, these decisions have created significant new questions in the process of resolving old ones. The precise scope of the supreme court's holding in *Covalt*, as well as its relationship to the 1989 amendment to the Indiana Product Liability Act,¹⁶² must be determined by future decisions. With respect to the second collision doctrine, although the two districts of the court of appeals agreed that a cause of action for enhanced injuries exists in Indiana, the burden placed on the party seeking to prove damages premised on that cause of action is substantially different in the two decisions—a difference that the Indiana Supreme Court may eventually have to resolve.¹⁶³

The analysis of the court of appeals in *Jarrell*¹⁶⁴ will almost certainly be critically reexamined in subsequent decisions. Whether a bulk manufacturer of chemicals has a duty to warn an employee of the purchaser of the chemicals is, or at least should be, a question of law for the court—not for the trier of fact. The domain of the fact finder is, traditionally, restricted to a determination of whether the defendant adequately discharged a duty to warn imposed by law. The holding in *Jarrell*, that the determination of both the existence of a duty to warn and the adequacy of those warnings are properly left to the finder of fact, seems inconsistent with the pre-existing case law and unwise.

160. See *supra* text accompanying notes 117-59.

161. See *supra* text accompanying notes 41-62.

162. See *supra* text accompanying notes 150-59.

163. See *supra* text accompanying notes 54-62.

164. See *supra* text accompanying notes 63-116.

Recent Developments in Worker's Compensation

ROBERT A. FANNING*

I. RECENT ATTEMPTS TO AVOID THE EXCLUSIVITY OF INDIANA'S WORKER'S COMPENSATION ACT REMEDY

The benefits provided by the Worker's Compensation Act are intended to be the exclusive remedy of an employee against his employer or those in the same employ. The Act clearly states:

The rights and remedies granted to an employee subject to IC 22-3-2 through IC 22-3-6 on account of personal injury or death by accident shall exclude all other rights and remedies of such employee, his personal representatives, dependents or next of kin, at common law or otherwise, on account of such injury or death, except for remedies available under IC 16-7-3.6.¹

This provision is the foundation upon which the Worker's Compensation Act is built. Predictably, the limited financial remedy available under the Act has led to the bringing of claims intended to circumvent the Act and the exclusive remedy provided under this section. Attempts to chip away the exclusive remedy foundation, however, have met with only limited success in 1989.

Cases challenging the exclusive remedy of worker's compensation in Indiana can be divided into three general categories:² (1) cases in which the employer is alleged to have acted intentionally³ or fraudulently;⁴ (2) cases where a co-employee is alleged to have acted outside the scope of his employment;⁵ (3) cases where the employee is alleged to be outside the scope of his employment.⁶ Cases involving all three categories were

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1. IND. CODE § 22-3-2-6 (1988).

2. A fourth category which has not been successful in Indiana relates to the argument that the employer acts in a dual capacity. *See Kottis v. United States Steel Corp.*, 543 F.2d 22 (7th Cir. 1976), *cert. denied*, 430 U.S. 916 (1977) and *Needham v. Fred's Frozen Foods, Inc.*, 171 Ind. App. 671, 359 N.E.2d 544 (1977).

3. *Blade v. Anaconda Aluminum Co.*, 452 N.E.2d 1036 (Ind. Ct. App. 1983).

4. *Baker v. American States Ins. Co.*, 428 N.E.2d 1342 (Ind. Ct. App. 1981); *Wolfe v. Commercial Union Ins.*, 792 F.2d 87 (7th Cir. 1986); *McCutchen v. Liberty Mut. Ins. Co.*, 699 F. Supp. 701 (N.D. Ind. 1988).

5. *Martin v. Powell*, 477 N.E.2d 943 (Ind. Ct. App. 1985).

6. *Consolidated Products, Inc. v. Lawrence*, 521 N.E.2d 1327 (Ind. Ct. App. 1988).

decided by the Indiana Court of Appeals during the survey period.

*Shelby v. Truck & Bus Group, Division of General Motors Corp.*⁷ contains both category 1 and 2 challenges to compensation as the exclusive remedy. Shelby sued Truck and Bus Group and his supervisor for injuries sustained by Shelby when his supervisor stuck a hot metal rod into Shelby's groin.⁸ The trial court granted Truck and Bus Group's motion for summary judgment. The court of appeals affirmed the summary judgment, holding that Truck and Bus Group was not liable for the act of a fellow employee which was not within the scope of the fellow employee's employment.⁹

The court rejected Shelby's claim that an employer could be held liable for the intentional tort of an employee by virtue of the doctrine of *respondeat superior*. The court reasoned that in order to hold an employer vicariously liable for the actions of its employee, the employee's actions must have been committed while he was acting within the scope of his employment.¹⁰ Acts done on the employee's own initiative, not in the service of the employer, are not within the doctrine of *respondeat superior* and are, therefore, not the responsibility of the employer unless the act occurred pursuant to the employer's direct order or by an employee acting as the alter ego of the employer.¹¹ In *Shelby*, it was not alleged that the employer directed the supervisor's act or that the act was part of the supervisor's job. Thus, the employer was not responsible outside the Worker's Compensation Act for the supervisor's actions.¹²

Interestingly, Shelby tried to avoid summary judgment by arguing that the question of whether the supervisor's act was intentional or negligent was sufficient to preclude summary judgment.¹³ The court properly noted that if the supervisor's act was intentional, it was not within the scope of his employment, thereby precluding a claim against Truck and Bus Group.¹⁴ Further, if the supervisor's act was negligent, Shelby's exclusive remedy would be under the Worker's Compensation Act.¹⁵ In either event, therefore, summary judgment was proper as to Truck and Bus Group.

Although Shelby's action against Truck and Bus Group could not be maintained, Shelby could maintain an action against his supervisor,

7. 533 N.E.2d 1296 (Ind. Ct. App. 1989).

8. *Id.*

9. *Id.* at 1298.

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 1298-99.

14. *Id.*

15. *Id.*

based upon the allegation that the supervisor acted outside the scope of his employment. It remains to be seen whether Shelby will obtain a recovery in that action.

An example of a case involving an allegation that the employee was acting outside the scope of employment, a category 2 case, is *Thiellen v. Graves*.¹⁶ In *Thiellen*, Thiellen and Graves were driving in their employer's parking lot when an accident between the two occurred.¹⁷ The trial court granted summary judgment in favor of the defendant. Thiellen appealed, arguing first that his injury did not arise in the course of his employment, and that Graves, though also employed by Thiellen's employer, was not a co-worker at the time of the accident.¹⁸

The Court of Appeals for the Second District held that the scope of employment necessarily includes a reasonable period of time before and after work, particularly to enter and leave the actual work area.¹⁹ This holding is supported by Indiana precedents which have held that accidents in employer controlled parking areas are employment related risks.²⁰

Thiellen made a novel argument regarding the fellow employee aspects of the case which caused the court to review its prior holding in *O'Dell v. State Farm Mutual Automobile Insurance Co.*²¹ In *O'Dell*, the decedent was killed in an accident with a fellow employee on an employer-maintained road.²² After recovering for the death under the Worker's Compensation Act, the deceased's executrix brought suit against the co-employee. The trial court granted summary judgment in favor of the defendant, holding that the Worker's Compensation Act provided the exclusive remedy for the plaintiff.²³ In dicta, the court stated: "[T]he test must be that the statutory bar applies only when both employees were in the course of their employment, as determined by whether the denominated defendant could obtain compensation benefits if he were the claimant in the same or similar circumstances."²⁴ *Thiellen* alleged that Graves' driving was "reckless and wilful and wanton" and that

16. 530 N.E.2d 765 (Ind. Ct. App. 1988).

17. *Id.* at 766.

18. *Id.*

19. *Id.* at 767. In *Wayne Adams Buick, Inc. v. Ference*, the court held that trips to the employer's mailbox, located across the street from the place of business, was also part of employment related risk. 421 N.E.2d 733 (Ind. Ct. App. 1981).

20. *Id. See, e.g., Ward v. Tillman*, 179 Ind. App. 626, 386 N.E.2d 1003 (1979). *See also Goldstone v. Kozma*, 149 Ind. App. 626, 274 N.E.2d 304 (1971).

21. 173 Ind. App. 106, 362 N.E.2d 862 (1977).

22. *Id.* at 864.

23. *Id.* at 866.

24. *Id.*

her "reckless driving was contrary to law."²⁵ He then argued that had Graves been injured, she would have been barred from receiving compensation benefits by virtue of one or more of the affirmative defenses to compensation enumerated in the Act.²⁶ Thiellen therefore contended that Graves was not his co-employee pursuant to the *O'Dell* test because she would not have been entitled to receive worker's compensation benefits.²⁷

The Court of Appeals criticized the *O'Dell* test as overly broad.²⁸ The proper inquiry, according to the *Thiellen* court, is not whether the defendant co-employee would be entitled to compensation benefits, but rather, whether the defendant co-employee was engaged in an activity arising out of the course of employment at the time the accident occurred.²⁹ Since Thiellen and Graves had the same employer and Graves' action arose out of the course of her employment, she was a co-employee of Thiellen, notwithstanding that she may be subject to forfeit her worker's compensation benefits due to an affirmative defense available to the employer as to her. The court finally concluded that Thiellen's recovery was limited to that provided by the Act.³⁰

In *Sanchez v. Hamara*,³¹ the Court of Appeals for the Third District was called upon to decide a case quite similar on its facts to *Thiellen*. The Sanchezes sued Hamara for injuries which Mrs. Sanchez sustained when Hamara inadvertently closed the passenger door of her van on Sanchez' hand.³² The event in question took place in the company parking lot. The trial court granted summary judgment to Hamara, which the third district affirmed. The third district reached the same result as did the second district in *Thiellen*. However, the third district reached this result by applying the *O'Dell* test. It is important to note that the *Sanchez* court was not faced with the argument that Hamara would not have been entitled to benefits had she been injured in the same accident. Thus, the holdings in *Sanchez* and *Thiellen* can be reconciled.³³ It is

25. *Thiellen*, 530 N.E.2d at 768.

26. *Id.* See IND. CODE § 22-3-2-8 (1988).

27. *Id.*

28. *Id.*

29. *Id.* See *Ward v. Tillman*, 179 Ind. App. 626, 386 N.E.2d 1003 (1979).

30. 530 N.E.2d at 768.

31. 534 N.E.2d 756 (Ind. Ct. App. 1989).

32. *Id.* at 757.

33. One aspect of the *Sanchez* case which is disturbing relates to Mr. Sanchez's claim for loss of consortium. The claim failed because Mr. Sanchez took the position that he should be entitled to a common law claim for loss of consortium inasmuch as his wife had a common law claim for damages. The court dismissed the wife's claim and was, therefore, compelled to dismiss the husband's claim, but stated: "As the Sanchezes do not raise the issue whether Louis has a claim for loss of consortium against Barbara

the opinion of the author that while the rationale of the second district in *Thiellen* is appropriate, the *O'Dell* test is sufficient to determine whether or not the parties are in the same employ.

*Riverview Health Care v. Wright*³⁴ is an example of an attempt to avoid the exclusive remedy provisions of the Worker's Compensation Act by alleging that the employee was outside the scope of his employment at the time of the injury; a category 3 case. In *Riverview*, Wright was scheduled to report to work in the afternoon, but went to the employer's premises in the morning to pick up her paycheck.³⁵ Although the parking lot to the center was icy, she entered the premises without incident.³⁶ While inside, Wright completed enrollment forms for an employee benefit program.³⁷ Upon leaving the premises, she fell in the parking lot and was injured.³⁸

Wright filed a civil action against Riverview, alleging negligence. Riverview moved to dismiss the action, arguing that the Worker's Compensation Act afforded to Wright her exclusive remedy.³⁹ The trial court denied Riverview's motion, but Riverview again raised the exclusive remedy defense on two occasions during the trial. On both occasions, the trial court determined that it had jurisdiction to adjudicate the dispute and ultimately allowed the case to go to the jury.⁴⁰ The jury found that Riverview was not negligent.

Following the entry of judgment against her, Wright filed a claim with the Worker's Compensation Board.⁴¹ Although the claim was dismissed by the single hearing judge, it was reinstated by the full Worker's Compensation Board.⁴² On appeal, the court of appeals held that the doctrine of *res judicata* barred the employee from relitigating the issue of jurisdiction before the Worker's Compensation Board.⁴³ Although both the trial court and the Board possessed the authority to determine

where Maria's exclusive remedy is provided by the Act, we leave that question for another day." *Sanchez*, 534 N.E.2d at 758.

It should be noted that the spouse of an employee has no common law action against the employer by virtue of a compensable injury to the employee. See *England v. Dana Corp.*, 428 F.2d 385 (7th Cir. 1970); *Rosander v. Copco Steel & Eng'g. Co.*, 429 N.E.2d 990 (Ind. Ct. App. 1982).

34. 524 N.E.2d 321 (Ind. Ct. App. 1988).

35. *Id.*

36. *Id.* at 322.

37. *Id.*

38. *Id.*

39. *Id.*

40. Although it is not particularly clear, the trial court impliedly determined that Ms. Wright's injury was not in the course of her employment. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 323-24.

the jurisdictional issue, "once one tribunal exercised authority over Wright's claim and reached a final judgment on the merits, the other tribunal was precluded from re-evaluating the issues and facts of the claim."⁴⁴

Though apparently not raised by Riverview, the court of appeals also found that Wright was estopped from claiming that the Worker's Compensation Board had jurisdiction of her claim because she had argued to the trial judge that the Worker's Compensation Board was without jurisdiction. According to the court of appeals, "[a] party cannot assume inconsistent or mutually contradictory positions in the same or successive litigation."⁴⁵ This suggests that Wright's problem could not have been solved by presenting her claim to the Worker's Compensation Board and the court concurrently. Assuming that Riverview would not have challenged the Board's jurisdiction, it is reasonable to assume that the parties would have either voluntarily agreed to compensation or the Board would have awarded compensation. It would thereafter have been inappropriate for Wright to proceed with a civil action and argue that the Board was without jurisdiction. This presents a problem for the practitioner who is faced with a claim where the applicability of the Worker's Compensation Act is unclear. The best approach might be to promptly submit the facts to the Worker's Compensation Board for its determination as to the Board's jurisdiction. This approach is suggested because the Board is likely to be more expert with regard to the issues surrounding the "arising out of" employment test than a trial court which may be faced with that issue only infrequently. Further, the Board's procedures can be expedited so that a determination of the issue may be had in sufficient time to invoke the jurisdiction of a civil court in the event that the Board finds itself to be without jurisdiction.

It is interesting to speculate whether the Worker's Compensation Board would have found itself to have jurisdiction had the issue first been presented in that forum. It is possible that Wright's activity would have been found to be incidental to her employment, especially in light of the fact that she completed an employee benefit enrollment form. The case certainly highlights the risk of giving up the rather liberal, though financially limited, coverage of the Worker's Compensation Act in favor of proceeding in a civil forum where liability must be established by a preponderance of the evidence.

II. STATUTES OF LIMITATION IN WORKER'S COMPENSATION CASES

Two cases decided during the survey period dealt with statutes of limitations issues. As to the initial filing of claims, the Act states:

44. *Id.* at 323.

45. *Id.* at 325.

The right to compensation under IC 22-3-2 through IC 22-3-6 shall be forever barred unless within two (2) years after the occurrence of the accident, or if death results therefrom, within two (2) years after such death, a claim for compensation thereunder shall be filed with the worker's compensation board. However, in all cases wherein an accident or death results from the exposure to radiation, a claim for compensation shall be filed with the board within two (2) years from the date on which the employee had knowledge of his injury or by exercise of reasonable diligence should have known of the existence of such injury and its causal relationship to his employment.⁴⁶

Before 1947, the language of this section required that the statute of limitations be computed from the date of "the injury," which had been interpreted to mean the point at which the injury became manifest.⁴⁷ That language allowed for a much more subjective analysis as to when the limitations period began to run and therefore lacked certainty in defining when a claim was barred. In 1947, the section was changed to incorporate its present language which has been consistently held by the Worker's Compensation Board and the Courts of Appeals to require that a claim be filed within two years of the date of the "accident."⁴⁸

The only possible deviation from such consistency occurred in *Bogdon v. Ramada Inn, Inc.*.⁴⁹ In *Bogdon*, the issue was whether the employee had notified the employer of the injury within thirty days of the injury as required by the Act.⁵⁰ The *Bogdon* court held that for the purpose

46. IND. CODE § 22-3-3-3 (1988).

47. See, e.g., Standard Brands, Inc. v. Moore, 114 Ind. App. 500, 51 N.E.2d 865 (1943); American Maize Products Co. v. Nichiporchik, 108 Ind. App. 502, 29 N.E.2d 801 (1940).

48. See, e.g., Lewis v. Marhoefer Packing Co., 145 Ind. App. 225, 250 N.E.2d 375 (1969).

49. 415 N.E.2d 767 (Ind. Ct. App. 1981).

50. IND. CODE § 22-3-3-1 provides:

Unless the employer or his representative shall have actual knowledge of the occurrence of an injury or death at the time thereof or shall acquire such knowledge afterward, the injured employee or his dependents, as soon as practicable after the injury or death resulting therefrom, shall give written notice to the employer of such injury or death.

Unless such notice is given or knowledge acquired within thirty (30) days from the date of the injury or death, no compensation shall be paid until and from the date such notice is given or knowledge obtained. No lack of knowledge by the employer or his representative, and no want, failure, defect or inaccuracy of the notice shall bar compensation, unless the employer shall show that he is prejudiced by such lack of knowledge or by such want, failure, defect or inaccuracy of the notice, and then only to the extent of such prejudices.

IND. CODE § 22-3-3-1 (1988).

of the notice requirement of section 22-3-3-1, the time limit does not begin to run until the time at which a progressive injury becomes manifest.⁵¹

The language of the *Bogdon* opinion was not as clear as it might have been and has sometimes been said to justify the filing of a *claim* for compensation more than two years after the occurrence of an accident. An example of such a claim is found in *Ingram v. Land-Air Transportation Company*.⁵² The accident at issue in *Ingram* occurred in January of 1985, but no claim was filed with the Worker's Compensation Board until January of 1988.⁵³ *Ingram* had pain immediately after the accident, with gradually progressed and increased until December of 1987 when he sought additional medical care.⁵⁴ *Ingram* claimed that he did not know that he had been injured until December of 1987 when his pain became disabling.⁵⁵ The Worker's Compensation Board dismissed *Ingram*'s claim, which dismissal was affirmed by the court of appeals.⁵⁶

The decision of the *Ingram* court properly limited the *Bogdon* decision to its facts and reaffirmed the general rule that a claim must be filed within two years of the date of the accident. While the *Bogdon* court held that for the purpose of notification to the employer of an injury the time of the injury is when it becomes manifest, the *Ingram* court limited *Bogdon* to the construction of Indiana Code section 22-3-3-1, which contains language much different than that contained within Indiana Code section 22-3-3-3.⁵⁷

The applicable statute of limitations for the re-opening of a claim for additional medical expenses was considered in *Berry v. Anaconda Corp.*⁵⁸ The *Berry* decision makes it clear that claims for additional medical expenses must be filed within one year from the last day for which compensation benefits were paid.

Berry sustained a serious injury on January 25, 1984. He and *Anaconda* agreed to the payment of 50 weeks of temporary total disability benefits and 62.5 weeks of permanent partial impairment benefits. Both the temporary disability and permanent impairment benefits began on

51. *Bogdon*, 415 N.E.2d at 770.

52. 537 N.E.2d 532 (Ind. Ct. App. 1989).

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. IND. CODE § 22-3-3-1 has not been revised since 1929 and it seems quite likely that when the legislature amended § 22-3-3-3 in 1947, it inadvertently failed to amend § 22-3-3-1. There is no good reason for the difference in language and § 22-3-3-1 should probably be revised to require that the employee give notice to his employer within thirty days of the date of the *accident*, rather than within thirty days of the date of the *injury*.

58. 534 N.E.2d 250 (Ind. Ct. App. 1989).

January 26, 1984 and ended on September 19, 1985 and March 24, 1985 respectively.⁵⁹ Anaconda paid medical expenses for Berry through August 3, 1987. Thereafter, a dispute developed regarding the payment of additional medical bills.⁶⁰ Berry filed an application with the Worker's Compensation Board on March 10, 1988 to review the prior award based upon an alleged change of conditions. The Board dismissed his claim as not timely filed.⁶¹

In affirming the action of the Worker's Compensation Board, the court of appeals held that the provision of medical services is not compensation for the purpose of extending the statute of limitations to re-open a claim for additional compensation benefits or medical payments.⁶² The court of appeals noted that there is a distinction in the Act between awards for medical services and awards for compensation benefits.⁶³ As to the time within which an application for additional medical services must be filed, the court looked to Ind. Code § 22-3-3-27 which establishes two potential periods of limitation,⁶⁴ and quoted with approval from *Gregg v. Sun Oil Co.*:⁶⁵

Applications for the modification of an award of medical expenses must be filed within the latter one year statute of limitations, for that is the period of review incorporated by reference into the provisions of IC 1971, 22-2-3-4. . . . The language which constitutes the incorporation by reference expressly refers to the statutory period applicable to increased permanent partial impairment cases.⁶⁶

It appears that Berry would have had to file his claim for additional medical services on or before September 19, 1986, one year from the last date for which he received any compensation. Having failed in that

59. *Id.* at 251.

60. The underlying award specifically stated that the issue of Anaconda's responsibility for future expenses remained open for later determination. *Id.*

61. *Id.*

62. *Id.* at 253.

63. *Id.* at 252-53.

64. IND. CODE § 22-3-3-27 provides in pertinent part:

(c) The board shall not make any such modification upon its own motion nor shall any application therefor be filed by either party after the expiration of two (2) years from the last day for which compensation was paid under the original award made either by agreement or upon hearing, except that applications for increased permanent partial impairment are barred unless filed within one (1) year from the last day for which compensation was paid. The board may at any time correct any clerical error in any finding or award.

IND. CODE § 22-3-3-7 (1988).

65. 180 Ind. App. 379, 388 N.E.2d 588 (1979).

66. *Berry*, 534 N.E.2d at 253.

regard, his claim for the payment of additional medical expenses was properly dismissed.

A curious aspect of the *Ingram* and *Berry* decisions relates to the courts' recognition of the hardship imposed upon Ingram and Berry as a result of its decisions.⁶⁷ Hardship is the necessary result of any statute of limitations. Once having determined that the legal system is best served by establishing limitations beyond which claims cannot be brought, the hardship sometimes imposed must be accepted by all. It serves no useful purpose to attempt to place blame for the individual disappointment occasioned by the enforcement of the statutes in question.

III. DEFINING "OFFENSE" FOR THE PURPOSE OF THE AFFIRMATIVE DEFENSE CONTAINED WITHIN THE WORKER'S COMPENSATION ACT

One additional case which deserves discussion is *Hass v. Shrader's, Inc.*⁶⁸ In that case, Hass, while making a delivery, pulled into the emergency lane of the roadway in order to pass slow moving traffic. As he did, he ran into a truck parked in the emergency lane, sustaining severe personal injuries.⁶⁹

The employer claimed that Hass' injury was a result of his commission of a traffic code offense which precluded recovery under the Act.⁷⁰ The single hearing judge found for the employer as did the full Worker's Compensation Board. The full Board also found that Hass knowingly violated a statutory duty in addition to his commission of an offense.⁷¹

67. In *Ingram*, the court stated: "We are aware that our decision works a hardship on Ingram, and others similarly situated, a hardship that can only be remedied by the legislature which created it." *Ingram v. Land-Air Transp. Co.*, 537 N.E.2d 532, at 534 (Ind. Ct. App. 1989). The *Berry* court stated:

For the above reasons, Berry's argument is without merit. If the legislature had intended the result argued by Berry, it would have so stated. It is not our prerogative to rewrite plain statutory language. While the result is harsh, it is for the legislature to correct if it so desires. Consequently, this case is affirmed. *Berry*, 534 N.E.2d at 253.

68. 534 N.E.2d 1119 (Ind. Ct. App. 1989).

69. *Id.*

70. *Id.* at 1120.

71. *Id.* IND. CODE § 22-3-2-8 provides:

No compensation is allowed for an injury or death due to the employee's knowingly self-inflicted injury, his intoxication, his commission of an offense, his knowing failure to use a safety appliance, his knowing failure to obey a reasonable written or printed rule of the employer which has been posted in a conspicuous position in the place of work, or his knowing failure to perform any statutory duty. The burden of proof is on the defendant.
IND. CODE § 22-3-2-8 (1978).

The court of appeals held that traffic infractions are not an offense within the meaning of Ind. Code § 22-3-2-8.⁷² Further, the court of appeals held that the full Worker's Compensation Board could not raise an additional affirmative defense for the benefit of the employer.⁷³

The Worker's Compensation Act does not define the word "offense" so the court undertook an examination of other statutes and definitions.⁷⁴ Before 1983, most traffic violations were misdemeanors, but after 1983 the traffic code was de-criminalized and many violations which had been misdemeanors were made civil infractions. Also, the criminal code was amended to exclude an infraction as an offense, making only felonies and misdemeanors "offenses."⁷⁵ Although the employer argued that by changing the affirmative defense language in the Worker's Compensation Act from felony and misdemeanor to offense in 1978, the legislature must have meant to use the pre-1983 definition of offense which would include traffic violations, the court concluded that the legislature did not intend the word "offense" to include an infraction.⁷⁶

In the author's opinion, the 1983 criminal code and other changes should not affect the application of the affirmative defenses. For years, traffic violations have been deemed sufficient to prevent the payment of worker's compensation benefits. For example, in *DeMichaeli & Associates v. Sanders*,⁷⁷ the employee's failure to yield the right-of-way or to stop at a stop sign was found sufficient to bar compensation. At the time of the *DeMichaeli* decision, the traffic violations in question were Class C misdemeanors. After 1983, those violations became Class C infractions. However, the nature of the violation did not change. As William Shakespeare said, "a rose by any other name smells as sweet." The action of the court of appeals completely negates traffic violations as a basis for the affirmative defense without any showing that the legislature intended to materially affect the affirmative defense when the word "offense" was substituted for the words "felony" and "misdemeanor."

In *Hass*, the employer failed to raise the affirmative defense of a knowing violation of a statutory duty and the court of appeals properly held that because the affirmative defense had not been pled or proven by the employer, it was waived.⁷⁸ Pursuant to the rules of the Worker's

72. *Hass*, 534 N.E.2d at 1121.

73. *Id.* at 1121-22.

74. *Id.* at 1120-21.

75. *Id.*

76. *Id.*

77. 167 Ind. App. 669, 340 N.E.2d 796 (1976).

78. *Hass*, 534 N.E.2d at 1122. Of course, Shrader's may have considered the affirmative defense, but was unable to prove that Hass knew that it was a statutory violation to pass other vehicles in the emergency lane.

Compensation Board, affirmative defenses must be pled a minimum of 45 days prior to a hearing.⁷⁹

IV. CONCLUSION

The Indiana Courts of Appeals have generally been quite steadfast in protecting the exclusive remedy provisions of the Worker's Compensation Act. Likewise, the courts have rendered opinions which support the proposition that claims must be timely filed pursuant to the various statutes of limitations within the Act. Change has occurred as to one of the affirmative defenses where the court's action is at odds with prior similar cases and the collective wisdom of the Worker's Compensation Board.

79. IND. ADMIN. CODE tit. 630, r. 1-1-10 (1988) provides: "If the defendant relies upon the special defenses allowed by 22-3-2-8, such special defense must be pleaded by an affirmative answer filed no later than forty-five (45) days before the date set for hearing unless good cause shown for delay."

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